

**HOW TAX REFORM WILL SIMPLIFY OUR
BROKEN TAX CODE AND HELP INDIVIDUALS
AND FAMILIES**

HEARING
BEFORE THE
SUBCOMMITTEE ON TAX POLICY
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED FIFTEENTH CONGRESS
FIRST SESSION

JULY 19, 2017

Serial No. 115-TP02

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PUBLISHING OFFICE

33-482

WASHINGTON : 2019

COMMITTEE ON WAYS AND MEANS

KEVIN BRADY, Texas, *Chairman*

SAM JOHNSON, Texas
DEVIN NUNES, California
PATRICK J. TIBERI, Ohio
DAVID G. REICHERT, Washington
PETER J. ROSKAM, Illinois
VERN BUCHANAN, Florida
ADRIAN SMITH, Nebraska
LYNN JENKINS, Kansas
ERIK PAULSEN, Minnesota
KENNY MARCHANT, Texas
DIANE BLACK, Tennessee
TOM REED, New York
MIKE KELLY, Pennsylvania
JIM RENACCI, Ohio
PAT MEEHAN, Pennsylvania
KRISTI NOEM, South Dakota
GEORGE HOLDING, North Carolina
JASON SMITH, Missouri
TOM RICE, South Carolina
DAVID SCHWEIKERT, Arizona
JACKIE WALORSKI, Indiana
CARLOS CURBELO, Florida
MIKE BISHOP, Michigan

RICHARD E. NEAL, Massachusetts
SANDER M. LEVIN, Michigan
JOHN LEWIS, Georgia
LLOYD DOGGETT, Texas
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
JOSEPH CROWLEY, New York
DANNY DAVIS, Illinois
LINDA SANCHEZ, California
BRIAN HIGGINS, New York
TERRI SEWELL, Alabama
SUZAN DELBENE, Washington
JUDY CHU, California

DAVID STEWART, *Staff Director*

BRANDON CASEY, *Minority Chief Counsel*

SUBCOMMITTEE ON TAX POLICY

PETER J. ROSKAM, Illinois, *Chairman*

DAVID G. REICHERT, Washington
PATRICK J. TIBERI, Ohio
MIKE KELLY, Pennsylvania
JIM RENACCI, Ohio
KRISTI NOEM, South Dakota
GEORGE HOLDING, North Carolina
KENNY MARCHANT, Texas
PAT MEEHAN, Pennsylvania

LLOYD DOGGETT, Texas
JOHN B. LARSON, Connecticut
LINDA SANCHEZ, California
MIKE THOMPSON, California
SUZAN DELBENE, Washington
EARL BLUMENAUER, Oregon

CONTENTS

	Page
Advisory of July 19, 2017, announcing the hearing	2
WITNESSES	
The Honorable Bill Archer, Former Chairman, Committee on Ways and Means	10
Bernard F. McKay, Chairman of the Board of Directors, Council for Electronic Revenue Communication Advancement	15
Jania Stout, Practice Leader and Co-Founder, Fiduciary Plan Advisors at HighTower	25
Eric Rodriguez, Vice President, Office of Research, Advocacy, and Legislation, UnidosUS	35
QUESTIONS FOR THE RECORD	
Question submitted by The Honorable Patrick J. Tiberi, of Ohio, to Bernard F. McKay, Chairman of the Board of Directors, Council for Electronic Revenue Communication Advancement	72
Questions submitted by The Honorable Peter J. Roskam, of Illinois, to Bernard F. McKay, Chairman of the Board of Directors, Council for Electronic Revenue Communication Advancement	72
SUBMISSIONS FOR THE RECORD	
Americans for Prosperity (AFP)	78
The American Institute of Architects (AIA)	79
The American Institute of Certified Public Accountants (AICPA)	84
Church Alliance	95
Coalition to Preserve Cash Accounting	103
Insured Retirement Institute (IRI)	108
GradFin	115
American Citizens Abroad, Incorporated (ACA) and American Citizens Abroad Global Foundation	125
National Low Income Housing Coalition (NLIHC)	130
National Retail Federation (NRF)	140
Retail Industry Leaders Association (RILA)	141
The Christian Science Church	144
Center for Fiscal Equity	147
Precious Metals Association of North America (PMANA)	156

**HOW TAX REFORM WILL SIMPLIFY OUR
BROKEN TAX CODE AND HELP INDIVIDUALS
AND FAMILIES**

WEDNESDAY, JULY 19, 2017

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TAX POLICY,
Washington, DC.

The Subcommittee met, pursuant to call, at 2:31 p.m., in Room 1100, Longworth House Office Building, Hon. Peter J. Roskam [Chairman of the Subcommittee] presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON TAX POLICY

FOR IMMEDIATE RELEASE
Wednesday, July 19, 2017
TP-02

CONTACT: (202) 225-1721

Tax Policy Subcommittee Chairman Roskam Announces Hearing on How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families

House Committee on Ways and Means Tax Policy Subcommittee Chairman Peter J. Roskam (R-IL), announced today that the Subcommittee will hold a hearing on tax reform ideas that simplify our broken tax code, reduce the burdens on American families and individuals, and deliver economic growth that creates jobs and improves the quality of life of all Americans. **The hearing will take place on Wednesday, July 19, 2017, in room 1100 of the Longworth House Office Building, beginning at 2:00 p.m.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "[Click here to provide a submission for the record.](#)" Once you have followed the on-line instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, August 2, 2017.** For questions, or if you encounter technical problems, please call (202) 225-3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available at <http://www.waysandmeans.house.gov/>

Chairman ROSKAM. The Subcommittee will come to order.

Welcome to the Ways and Means Subcommittee on Tax Policy, our hearing on “How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families.”

Before we get started with opening statements and so forth, I would like to yield to the Chairman of the Ways and Means Committee, Congressman Kevin Brady, for the purposes of introducing a distinguished witness who is before us today. Mr. Chairman.

Chairman BRADY. Thank you, Chairman Roskam. First, thank you for your leadership of the Tax Policy Subcommittee at such an important time in America’s history. And thank you for leading hearings like this that allow America to have the conversation about creating a bolder, fairer, flatter, and more pro-growth Tax Code.

I want to thank all our witnesses for being here today. And I want to give a special welcome to our friend, my friend, Chairman Bill Archer, former leader of this Committee and a longtime mentor to me personally. Chairman Archer, thank you for being here to share your insights and your experience on tax reform.

I know everyone on our Committee is familiar with Chairman Archer, but I would like to take a moment to talk about him and his legacy here at the Ways and Means Committee.

Chairman Archer served on the Committee for 28 years and was Chairman from 1995 to 2001. During his service, Chairman Archer was closely involved in several historic efforts to make our Tax Code simpler and fairer for all Americans.

Prior to becoming Chairman, he was a strong voice in developing the Tax Reform Act of 1986, fighting throughout the process to lower rates for Americans and eliminate complexity for taxpayers.

And when he took the gavel in 1995, he brought that same passion and determination and insight, always striving to ensure that our Tax Code worked for the American people, not against them.

And he was a Chairman long before software that did his own taxes year after year. So he knew intimately the complexity and the cost of this complicated Code. So, in many ways, Chairman Archer’s leadership helped lay the foundation for the kind of pro-growth, bold tax reform we are pursuing today. And for me, his leadership often serves as a source of inspiration as we work to fix our broken Tax Code for families and individuals.

When Chairman Archer retired from Congress, I had the honor of being selected to his seat on Ways and Means. Now it is my great honor as Chairman to welcome you back to the Committee.

Chairman Archer, thank you for your decades of public service and thank you again for joining us today. We have so much to learn from you, and we are excited for your testimony.

Mr. ARCHER. Thank you for that welcome, Mr. Chairman. And thank you for the job you are doing on tax reform.

Chairman BRADY. Thanks, Chairman.

I yield back, Chairman Roskam.

Chairman ROSKAM. Thank you, Chairman Brady.

Think about it. Right now, on this iPhone, I can pull up an airline app. I can click a flight tool, O'Hare Airport. I can choose a seat. I can get an e-ticket mailed to me on my iPhone. I can have it charged to my credit card, and I can get a boarding pass all within the twinkling of an eye.

And if I have 10 seconds of that little loading thing spinning around, my attitude is, you know, what loser made this? Now, it is ridiculous. And, yet, we have an expectation of ease and simplicity that is basically the norm right now.

Now, contrast that with our Tax Code, which is so complicated that, every year, the majority of taxpayers can't figure out how much money they owe by themselves. Our Tax Code has grown so bloated over the past 30 years, to the point that it is draining our productivity and producing a headache for nearly every taxpayer.

Now, there is good news: Nobody likes it, and nobody defends it. There is nobody in this country that says: Oh, the Internal Revenue Code, I love that. Don't make any changes to that. Nobody likes it.

Now, people like certain elements of it, and we have deep divisions among us about the directions that we should go, but it is so interesting that nobody is defending the status quo.

Now, there is better news: We have a solution that will grow the economy, dramatically simplify the Code, and lower our tax bills every year. Last week, we discussed the importance of growth. Taxpayers, according to the proposal that we have set forth, would see growth from tax reform in the form of an estimated 1.7 million more jobs and 7.7 percent higher wages.

But today we will focus on the burden of filing taxes as an individual. Every year, millions of Americans spend hours trying to figure out what they owe. In fact, combined, Americans spend 2.6 billion hours trying to calculate what they need to pay Uncle Sam, and this translates into over \$400 billion in lost activity.

What should be a simple calculation is so complicated that 9 out of 10 people either pay a professional or have to buy software just to figure out how much they owe the government.

When I think about a household filing their taxes, I think about a family in my own constituency in Palatine, Illinois, sitting at their kitchen table with a box full of receipts trying to figure out what they owe. They are looking at the 1040, and they are trying to figure out what deductions they can take. Can they deduct enough for them to itemize, or do they want to take the standard deduction? Do they qualify for the additional standard deduction? Can they take both the personal exemptions for their children and the child tax credit? And when they really get confused about how much they need to pay the government, they can read the helpful

IRS guide for individuals, and by page 206—no lie—it starts out with how to figure your tax.

The whole time they are thinking in the back of their minds that, if they had enough money to hire somebody to do it for them, they would be paying less in taxes. That is because, for more than 30 years, the Tax Code has not been updated and it has ballooned with special interest.

The standard tax form, the 1040, now contains more than 80 different items, and the additional complexity is a cost for everybody. Clearly, something is inherently unfair when the family from Palatine perceives that they pay more to the government because they don't know more about the Tax Code.

What we propose for individuals filing is something as simple as a postcard. Now, if you can add and multiply, you can do your own taxes. No more uncertainty, no more worrying that the government will come after you. We will have this postcard available in an on-line form and a hard copy form for every taxpayer to use.

Why did we make it this simple? And how did we make it this simple? First, we proposed to eliminate all but two deductions, and we took the seven brackets and reduced them to three, lowering the tax rate for all Americans in the process.

Then we paired together the standard deduction, the additional standard deduction, and the personal exemption for taxpayer and spouse, and we used the savings from eliminating deductions to double the standard deduction—and we expect that 95 percent of Americans will use that.

Finally, we combined the child tax credit with the personal exemption for children and dependents into one larger credit. With these changes, Americans will no longer have to worry if they are wealthy enough to get a better deal on taxes. It will be laid out in plain English for all to see.

Now, as a Committee, we have a choice. We can accept high rates and a confusing Code, or we can grow the economy, lower rates, and create a fairer system that Americans can trust. And I think the choice is clear.

With this in mind, I am pleased to welcome our witnesses, and I look forward to hearing all of your testimony and to working with my colleagues on both sides of the aisle to determine how we can create the best Tax Code that helps all Americans, including my constituents in Palatine and elsewhere.

Now, for the purpose of his opening statement, I would like to recognize my distinguished friend, the Ranking Member, Mr. Doggett, from Texas.

Mr. DOGETT. Thank you, Mr. Chairman, for your courtesy.

And welcome to all of our witnesses.

Today, we do finally consider the impact of proposed tax reform on individual taxpayers. This is the first consideration of this matter in the 13 months that have passed since the House Republican blueprint was announced.

Our hearing coincides with what appears to be the demise of the first Republican tax cut this year, which largely masqueraded as a health reform bill. It is instructive to consider how that bill proposed to assist individual taxpayers.

From the more than \$400 billion in tax breaks for individuals that is proposed in that bill, those making more than \$1 million each year would have pocketed an average of \$57,000 apiece. Any small tax cuts for middle class families would have been mostly wiped out by increased healthcare cost.

It is also instructive to look at how that bill was presented and to hope that lessons have been learned from the approach of putting the bill under lock and key in the Capitol, denying even some Republicans an opportunity to see the bill, then rushing it through without a single administrative official or expert coming forward to testify about the bill or be held accountable for it, all in an all-night session where all Democratic amendments were denied.

One would hope that experience, given the failure of the bill, would not be repeated. However, there is some concern in questions that have been raised in the Senate Finance Committee this same week as to whether any tax reform legislation will be presented for a hearing.

Senator McCaskill asks Chairman Orrin Hatch to commit that there would be a hearing on tax legislation and that it would not all be written behind closed doors. I will submit for the record an exchange about that with Senator McCaskill, and I hope that we will not see the same thing happen here in the House and that Senator Hatch will reconsider and make this a more open process.

[The submission of The Honorable Lloyd Doggett follows:]

Excerpt from Full Committee Hearing: Comprehensive Tax Reform: Prospects and Challenges
Senate Finance Committee
Tuesday, July 18, 2017

Sen. McCaskill: So, um, the Chairman is not here, but I would once again turn to the chairman and say to the chairman, Mr. Chairman, will we have a hearing on the tax reform bill? Will the Republicans allow us to have a hearing in the Finance committee on the proposal that is going to restructure our tax code. Is that going to be possible? Do you have any idea, as the ranking member, Mr. Wyden? Oh good, here's the chairman. Mr. Chairman, I'm asking my question again: I'm asking you, Mr. Chairman, Will we have a hearing in the finance committee on the tax reform proposal that you all plan to vote on on the floor of the Senate?

Sen. Hatch: Well, I'd like to. I don't know, as of right now.

Sen. McCaskill: Wouldn't that be normal order?

Sen. Hatch: Uh, yes and no. It depends. It depends on who's running. I've seen some Democrat times when it was not regular order. But be that as it may, I'd prefer to do hearings if we can.

Sen. McCaskill: Well that's great to hear, Mr. Chairman. I am...

Sen. Hatch: I'm not saying we're going to, but I'd prefer.

Sen. McCaskill: I'm a member. And I had this idea that I was coming to this committee to actually consider important matters of finance to our government. And there is no more important item of finance to our government than the structure of our tax code. There is nothing that is more impactful on our economy or on businesses and job creation in this country than the tax code. If we cannot have a hearing in the United States Senate in the Committee on Finance, on tax code reform, then I don't know why we have this committee. It doesn't make sense to me. So I am very hopeful, Mr. Chairman, that there will be a proposal. You said in your opening statement you hope the Democrats want to work on tax reform—you weren't sure that all wanted to work on tax reform, you hoped some do. I can assure you, Mr. Chairman: All the Democrats want to work on tax reform. We all want a seat at the table. And so I am imploring you to use your influence on Senator McConnell to allow us to have a hearing in this committee.

Sen. Hatch: Well you'd be idiots if you didn't want to work on tax reform. I know you all do, and I intend to see that you do. That's what this hearing is about, by the way.

Sen. McCaskill: We don't have a proposal, Mr. Chairman. This is all hypothetical and policy—which is great, I'm glad we're having it—but this is not on a proposal that would actually change the tax code. We have nothing in front of us, in terms of proposal. Nothing from the administration, nothing from the Republican majority. It is a far cry from the Finance Committee hearings that you have sat through for decades in this Senate that have looked through the specifics of legislation.



Mr. DOGGETT. Certainly, there is a need to simplify our Tax Code. Many of the additions to the Code have, in fact, been made in recent years in this very Committee, as loopholes and special advantages were offered to some that added complexity to the system.

I have authored legislation that is designed to consolidate existing credits for higher education into an expanded American opportunity tax credit to make it easier for more young people and not so young to access college and to use the same credit for job training, as so many Americans are trying to seek new opportunities that will make it possible for them to provide for their family in a more adequate way.

This bill would also ensure that students receiving Pell grants can get the full benefit of the American opportunity tax credit. That is important because, at this very time, the House Budget Committee is considering a budget that makes incredible cuts to education and social services, including the funds that are available for Pell grants.

Our Ranking Member, Mr. Neal, has advanced legislation to make the earned income tax credit available to the working poor who have no dependent children, an idea Speaker Ryan has endorsed, though not with sufficient enthusiasm to get it passed when it was considered in 2015.

Ms. DeLauro, our colleague, has offered a bill to expand the child tax credit.

I think each of these offer a potential for discussion but not if they are only to be crumbs off the table that has been set like the last tax cut bill for those earning more than \$1 million a year.

I think as we look at individuals, it is very important to apply the Mnuchin rule. That would be the rule named after President Trump's appointee, Secretary of the Treasury, Mr. Mnuchin, who has said he was not seeking any net tax breaks for the wealthiest few, that he would ensure that, while we simplified and added fairness to the Code, that there would not be a net tax cut for those at the top, actually as Mr. Trump had originally proposed and is proposed in the blueprint.

I would like to see us follow that rule as we consider simplicity and fairness. And I think that any action we take does have to be balanced against the many wrongs that are being committed as we meet in the Budget Committee to cut back on job training and educational opportunities.

Thank you, Mr. Chairman. I look forward to hearing our witnesses.

Chairman ROSKAM. Thank you, Mr. Doggett.

I think you make a couple of interesting points. Let me just comment briefly before I introduce the witnesses.

I think the admonition about process is a good one. We know what failure looks like. We know when Nancy Pelosi, as Speaker of the House, said, "We have got to pass this bill so that you know what is in it," that creates confusion and failure and a lack of cohesiveness.

I was on this Committee sitting right down there when we were considering the healthcare bill when Charlie Rangel, former Chairman, was sitting in this very chair. And when he was asked, I think it was either by Dave Camp or one of the other senior Repub-

licans of the Ways and Means Committee at the time, "When are we going to hear about the Republican amendments," Charlie Rangel said, soon, and very soon. It is a line from a gospel song that I remember as a child. That is why I have an independent recollection of it. And, of course, we never got to those points.

Now, we are having our fourth hearing on the blueprint. There has been a lot of discussion, a lot of discussion on the Camp draft as a prelude, a lot of discussion about the blueprint. And I think now is the perfect time to transition to having more insight on this by introducing our panel.

First of all, we have the Honorable Bill Archer, who Chairman Brady already introduced as the former Chairman of the Committee on Ways and Means and is here as an example of somebody who knows how to craft legislation and bring something to fruition.

And, Mr. Chairman, we welcome your testimony.

Next is Bernard McKay. He is the Chairman of the Board of Directors at the Council for Electronic Revenue Communication Advancement.

Next is Jania Stout, Practice Leader and Co-Founder of the Fiduciary Plan Advisors at HighTower.

And, finally, Eric Rodriguez, Vice President for the Office of Research, Advocacy, and Legislation at UnidosUS.

So I thank all four witnesses. You each have 5 minutes. If you go over the time, I will be gentle and then increasingly harsh to get you to have some tight corners, and then we will inquire of you.

So we will hear from you in order. Chairman Archer.

**STATEMENT OF THE HONORABLE BILL ARCHER,
FORMER CHAIRMAN, COMMITTEE ON WAYS AND MEANS**

Mr. ARCHER. Thank you, Mr. Chairman.

It is truly an honor to be in this room again.

Chairman ROSKAM. Chairman, can you make sure that mic is on?

Mr. ARCHER. I pressed the top button, but it doesn't seem to be—

Chairman ROSKAM. Scooch closer.

Mr. ARCHER. How is that? I don't know what else to do, Mr. Chairman.

Chairman ROSKAM. I think that is better. Just lean forward when in doubt.

Mr. ARCHER. All right. I will get as close as I can.

As Chairman Brady said, I have spent many years of my life in this room, and I have a great respect for it and great admiration to each of you who serves today.

When I was on this Committee, there were many challenges and many opportunities, and they exist today, and they probably will exist 25 years from now. But I think the Congress has perhaps a unique capability to alter the course of our country in a positive and a momentous way.

I pray that you will be allowed to rise to the occasion and complete the long-delayed goal of fundamental tax reform, which would simplify and rationalize our Tax Code.

The world has changed dramatically since my congressional service ended in the year 2001. For Americans to compete in the world

as both individuals and businesses is in many ways much more difficult and certainly more challenging than it was.

Tax rates have risen and complications have increased. I understand that there have been over 15,000 changes in the Tax Code since the 1986 tax reform. That is very difficult for individuals to cope with. And, frankly, that figure is probably out of date. It is probably much greater today.

I commend the efforts of the Committee and particularly Chairman Brady for taking the lead to advance the indisputable goal of simplifying the Code and helping to make the United States a leader in the world in terms of having a Tax Code that gives our country a competitive advantage in the marketplaces of the world.

I count myself as being a fair individual, and all I ever want for this country is a fair advantage. And hopefully—that is what we had in our Tax Code 30 years ago, but we have lost it. In my opinion, it is not enough to achieve tax parity with the rest of the world. As I said, we need to work to develop a clear and competitive lead.

The blueprint that was released last year as a starting point for the Committee's discussion is a truly comprehensive document and a courageous one as well. It was built in many respects on the actual bill introduced several years ago by former Chairman Dave Camp.

Foundations have been laid for a debate that is long overdue. I know well of vagaries and the twists and turns of the legislative process, but I urge you to plow ahead to develop a comprehensive document that clearly will be the new starting point for this effort.

Not only did I do my own Federal tax return, as Chairman Brady mentioned, but I did it with a pencil and a yellow writing tablet and not a computer. Believe me; it took a lot of my time. It was very frustrating, but I at least had the help of the staff of the Joint Committee and the Ways and Means Committee to help me when I got into real difficulty.

And I did that particularly on one part of the Code that related to the tax deductions for Members of Congress. There was no form. And so I contacted the Joint Committee and was told: Well, we can't give you a form. But I think we can tell you how to prepare one by hand, and I believe the IRS will take it.

Well, that is a terrible Tax Code. I hope that has been corrected since then, but I doubt that it has.

I do not in any way belittle the political effort needed to achieve the goal which you seek. But there is a support group of many, many Americans who may not be heard to offset the support group for every special provision that is in the Code that you must counteract in order to be able to finally reach your goal.

Until recently, one of the real problems has been expiring tax provisions, which required almost annual legislation and whose costs would have to be incorporated into any major bill. I commend the Committee and the Congress for having so aggressively addressed this problem in 2015.

It was clearly a master stroke to make tax reform possible. Inherent in this effort was the concept of permanence in the Tax Code. I urge you to make this the hallmark of any tax legislation. The American public needs to be able to plan and make their finan-

cial decisions in an environment where the tax provisions do not change every year.

That makes it extremely difficult. I have always described our Tax Code as an attractive nuisance, and to me, that is what an income tax is. And for those of you who are not lawyers, an attractive nuisance means that whatever you provide is going to, like a magnet, draw in all kinds of complications that are going to be very difficult to resist.

And that is what we have today. Sadly, I think every income tax does that. And I am going to ad lib just very quickly and tell you that I lost confidence in being able to really have an effective and a simple income tax at the end of the 1986 deliberations.

I personally said, and it is a matter of record, I think we should abolish the entire Code and replace it with a consumption tax to where the individuals in this country do not have to deal at all with the IRS.

To me, that would be very, very attractive. But that is a big step, and it is a step that is beyond where you can go. I couldn't make it happen. So I am sure you are not going to be able to make it happen. But, certainly, we need to find a better way than the current income tax.

I appreciate the unique opportunity to return to this hallowed environment, the most beautiful room in the Capitol of the United States, and to be able to address you. I don't have a magic answer for you. I wish I did. I think it is extremely complicated, and I am glad, frankly, that you are up there today and I am not.

Chairman ROSKAM. Thank you, Mr. Chairman.

Mr. ARCHER. But in any way that I can be helpful, please call on me.

[The prepared statement of Mr. Archer follows:]

Testimony of the Honorable Bill Archer

Subcommittee on Select Revenue Measures of the House Committee on Ways and Means

Wednesday, July 19, 2017

Mr. Chairman, Ranking Member Doggett and Members of the Subcommittee

It is a distinct honor to address Members of this Committee on which I served for 28 years, including six years as Chairman. Then, as now, the challenges were great but also were the opportunities. I personally believe that this Congress has a unique chance to alter the course of our country in a positive and momentous way. I pray that you will be allowed to rise to this occasion and complete the long delayed goal of simplifying and rationalizing our tax code.

The world has changed radically since my Congressional service ended in 2001. For Americans to compete in the world as both individuals and businesses is in many ways much more difficult – and certainly more challenging. Tax rates have risen and complication has increased – I am told that there have been over 15,000 changes to the Internal Revenue Code since the last attempt of comprehensive reform in 1986 – and that figure may be on the low side today.

I commend the efforts of this Committee and particularly Chairman, Kevin Brady, for taking the lead to advance the indisputable goal of simplifying the Code and helping to make the United States a leader in the world in terms of having a tax code that gives our country a competitive advantage in the marketplaces of the world. In my opinion, it is not enough to achieve tax parity with the rest of the world – we need and should work towards having a clear competitive lead.

The Blueprint that was released last year as a starting point for this Committee's discussion of tax reform is a momentous document and a courageous one as well. This Blueprint was built in many respects on the actual bill introduced several years ago by former Chairman Dave Camp. The foundations have been laid for a debate that is long overdue. I know well the vagaries - and twists and turns - of the legislative process but I urge you to plow ahead to develop a comprehensive document that clearly will be the new starting point for this effort.

In my opinion, business only tax reform as some have promoted cannot address the fundamental problems of our Tax Code – and our economy's need for greater growth and employment. For that reason, I am encouraged by the topic of your hearing today. Central to successful tax reform is tackling both the individual and business sides of the tax ledger. One without the other will just postpone the reckoning day that has to come if we are to remain the economic powerhouse of the world.

I have often called myself the poster child for tax reform. As Chairman, I prepared my own tax returns because I believed that I had to experience the same process as every other taxpayer. I would lock myself in my office to struggle through the entire effort – using paper and pencil – not a computer program. It was a multi-day effort! I had one advantage that the ordinary taxpayer did not – when an issue arose that defied my abilities to understand, I could call both the Ways and Means staff and the

staff of the Joint Committee on Taxation to get help. I didn't do it often – but on several occasions it was critical to my preparation of an accurate return. When I retired from Congress and moved to the private sector, I found it impossible to do my return on my own any more. Not only did my federal return get more difficult but, since my employer tracked my hours by what state I was in, I also faced filing in multiple states – where I wasn't even a resident.

While I will probably never qualify to file using it, I would urge your efforts to move towards a tax system where the vast majority of Americans can file on a postcard or at least a short – and uncomplicated – form. I have seen the mockup of such a postcard as displayed by Chairman Brady and find it intriguing and encouraging. I do not discount the political effort needed to achieve this goal. It will be heavy lifting of an enormous magnitude. As I found out as a Member of this Committee, there is a support group for every provision in the Internal Revenue Code – it will take courage and fortitude to move in this direction but I personally believe that it will be endorsed enthusiastically by the American public.

Until very recently, one of the greatest impediments to significant tax change has been the overhang of constantly expiring tax provisions, which required almost annual legislation and whose cost would have to be incorporated into any major bill. I commend the Committee and the Congress for having so aggressively addressed this problem in 2015. It was clearly a master stroke to make tax reform possible. Inherent in this effort was the concept of permanence in the tax code. I urge you to make this a hallmark of any tax legislation. The American public needs to be able to plan and make their financial decisions in an environment where our tax code does not resemble a roller coaster of ups and downs – of provisions here one year and not the next. Please don't discount the importance of a stable and permanent code.

I have always described our tax code as an attractive nuisance – that is a term that the lawyers in this room will understand! It attracts anyone with a legislative agenda to try and reach their goals by legislating through the tax code. We need to return to the essential goal of any tax system – to raise those monies needed to fund our government's activities in a simple and understandable fashion that does not place huge administrative and time burdens on our citizenry. I believe that this is achievable in this Congress and I commend your efforts in that direction.

I appreciate this unique opportunity to return to this hallowed location where I spent so many years of my life. My appreciation to Chairman Roskam, Ranking Member Doggett and the members of this Subcommittee for this honor and privilege.



Chairman ROSKAM. Thank you.
Mr. McKay.

**STATEMENT OF BERNARD F. MCKAY, CHAIRMAN OF THE
BOARD OF DIRECTORS, COUNCIL FOR ELECTRONIC REV-
ENUE COMMUNICATION ADVANCEMENT**

Mr. MCKAY. Thank you, Mr. Chairman and Ranking Member Doggett. I am honored today to testify on behalf of the Council for Electronic Revenue Communication Advancement, CERCA, the electronic tax filing association.

CERCA was launched in 1994 at the request of the IRS to provide a means of collective communication and coordination and co-operation across the tax ecosystem for advancing electronic tax filing and electronic tax administration.

CERCA members represent a wide diversity of industry participants and innovators from tax software and technology firms to the largest national tax storefront chains to systems integrators, payroll houses, and financial services companies.

We are proud to have been a part of leading the national adoption of electronic tax filing for more than two decades. In the 1998 IRS Restructuring and Reform Act, government adopted a public policy objective of achieving 80 percent e-file adoption by American taxpayers because electronic filing is more efficient, speeds return submission processing, reduces government operating costs, and improves accuracy.

And, today, almost 90 percent of all individual tax returns are electronically filed. That accomplishment is a direct outcome of public/private partnership and technology innovation. But innovation in the tax compliance process is not the only thing that has changed over the last 30 years since the Tax Code was last comprehensively changed.

The makeup of the American family and characteristics of small business have changed and evolved in many ways. Modernization and simplification of the Tax Code would empower individuals and small businesses to more easily understand their own taxation, and knowledgeable citizen engagement in their financial affairs, like tax, leads to better financial decisions for themselves and their families.

The private sector's development of tax preparation software over the last 30 years has sharply reduced the pain and complexity of tax compliance for average Americans while bringing accurate preparation and speedy filing of returns within economical reach for all, whether taxpayers prepare their own returns or are assisted by professional tax practitioners.

Private sector innovation has taken complexity of the Tax Code and simplified it for the taxpayer. Industry has driven data-driven innovation and simplified it for the taxpayer by allowing, for example, direct importation of financial data into tax returns at the taxpayer's direction, drawn directly from the original financial data sources.

These kinds of technological innovations have made tax compliance faster, easier, and more accurate. However, tax simplification reforms, streamlining the Tax Code itself, could accelerate greater

simplicity and ease of compliance, benefiting every taxpayer. It would be the right policy direction for the Nation.

We believe simplification reform strategy could begin with thoughtful application of commonsense solutions. Within the Code, there are unique terms like “adjusted gross income” as well as common terms like “dependent” and “income,” all of which have different and sometimes conflicting and certainly unique definitions to the Code.

Using universal definitions and commonly understood language would go a long way toward taxpayer ease and understanding. Similarly, the multiplicity of different tax provisions for retirement and education can leave taxpayers uncertain over what choices are best for them and their individual financial future.

The commercial sector knows that the natural behavioral response of a consumer to a multiplicity of options and complexity of choices can lead to doing nothing at all. Industry works to simplify this and has done so for decades, but actually simplifying the underlying Tax Code would make a big difference and help taxpayers make better decisions for their financial future.

In the same way that electronic filing was a public/private partnership, in 2002, President Bush wanted to ensure free tax services were available to low- and middle-income taxpayers to reduce compliance burden. That policy objective led to creation in 2003 of the IRS Free File program, which is provided at no cost to either the government or the taxpayer using the services. The result over the last 15 years has been a donation of more than 50 million free tax returns and electronic filings to American taxpayers of modest means. It is operated under standards, requirements, and consumer protections, governed by the IRS while ensuring competition and consumer choice.

That kind of public/private partnership has saved public funds and saved taxpayer compliance costs. More recently, a public/private partnership between the IRS, the State departments of revenue and the private sector was instituted to fight cyber fraud being launched against the American tax system internationally. That effort, the IRS Security Summit, has now been underway for more than 2 years, and IRS has reported that it has slashed cases of reported identity theft refund fraud by more than 50 percent.

And to take the fight to the next level, the summit has created an Information Sharing and Analysis Center, a tax ISAC, as exists in the financial services sector and the aviation sector, as the next phase of the public/private partnership to ensure a proactive strategic defense long term.

As policymakers contemplate tax simplification reform, it will be important that public/private partnership and these divisions of labors be preserved and strengthened.

Over the last several years there has been much discussion about creating a simplified postcard tax return. We would observe that, in today’s environment, we are really talking about an electronic postcard, as the American tax system has moved well beyond paper.

Moreover, an electronic postcard would fully benefit from the essential security safeguards already adopted by the IRS security

summit process, which protects both the taxpayer and the integrity of the tax system.

[The prepared statement of Mr. McKay follows:]



Council for Electronic Revenue Communication Advancement (CERCA)
Bernard McKay, Chair

House Committee on Ways and Means
Subcommittee on Tax Policy

How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families

July 19, 2017

COUNCIL FOR ELECTRONIC REVENUE COMMUNICATION ADVANCEMENT
7137 Main Street | Suite B | Clifton, Virginia 20124
Tel: 703-830-4789 | Fax: 703-991-5575 | E-Mail: cerca@cerca.org | Web: www.cerca.org

Mr. Chairman and Members of the Committee. I am honored today to have the opportunity to testify on behalf of the Council for Electronic Revenue Communication Advancement (CERCA) -- the electronic tax filing and innovation association -- about the critical importance that simplification of the tax code should play within tax reform.

CERCA was launched in 1994 at the request of the Internal Revenue Service to provide a means of collective communication and cooperation within the tax ecosystem for advancing electronic tax filing and electronic tax administration. CERCA members represent a wide diversity of industry participants and innovators, from tax software and technology firms, to the largest national chains offering tax preparation services, to the largest systems integrators and payroll houses, to financial services companies offering banks product and credit card services.

CERCA is proud to have been a part of leading the national adoption of electronic tax filing for more than two decades and an array of innovative technology advances within the tax ecosystem. In the 1998 IRS Restructuring and Reform Act, the US Government adopted a public policy objective of achieving 80% e-file adoption by American taxpayers because e-filing is more efficient, improves return submission processing, reducing government operating costs and improves accuracy. That national objective has in fact been exceeded, as e-filing now represents the tax return submission methodology for almost 90% of all individual tax returns. That accomplishment is the outcome of a fusion of public-private partnership and technology innovation.

But innovation in the tax compliance process is not the only thing that has changed over the last several decades. Over the past 30 years, since the tax code was last comprehensively changed, the make-up of the American family and characteristics of small businesses has changed and evolved in many ways. The time has come when truly modernizing and simplifying the tax code would be in everyone's interest. It would empower individuals and small businesses to more easily understand their taxes. It would also allow them to make better financial decisions, since tax compliance is the one time each year that the average family takes stock of their financial situation. And importantly, simplification reform could ultimately help grow our economy and make our system of tax Voluntary Compliance more successful, efficient and effective.

The private sector's development of tax preparation software has reduced much of the pain and complexity of tax compliance for average Americans, while bringing accurate preparation and speedy filing of returns within economical reach for all, whether taxpayers prepare their own returns or are assisted by professional practitioners. But private sector innovation is not enough. Tax simplification reform would benefit everyone and would be the right policy direction.

Tax Simplification

We believe a tax simplification reform strategy could begin with a thoughtful application of common sense solutions. Some of the most common difficulty and confusion today comes from the use of what may seem to be basic concepts in the current tax code, but which in the real world represent great confusion for taxpayers. One example is the tax code's use of the term

“Adjusted Gross Income (AGI)”. Most taxpayers simply don’t know what the term means, or what it applies to. Historically, this disconnect has contributed directly to e-file rejects since entering prior year AGI was a key authentication step for e-file acceptance.

Another example is that today there are a half dozen different and conflicting definitions of the term “dependent”, which apply to various tax provisions. Just as a practical matter, the average taxpayer and American family find it difficult to navigate the various differences and distinctions in the code for the identical term. And yet, understanding and applying that tax language is a very important part of American tax compliance and return accuracy.

Similarly, the range of specialized savings vehicles can create confusion on a practical level as to the tax status, treatment, rules and differences of the various alternatives. The multiplicity of current tax provisions for retirement and education leave many taxpayers uncertain over which may really apply to them or what the rules may be, which may result in under-utilization of provisions for which the taxpayer may be eligible. For example, the current code requires taxpayers to decipher 11 different kinds of IRAs, three distinct ways to help with childcare, and 14 varying education incentives. Each carries its own complex rules and multiple definitions of terms. The natural behavioral response to a multiplicity of options and choices can too often be inaction.

Beyond the need for streamlining the choices of tax options, and needed adoption of simplified tax terms, the tax code also needs to catch up with the realities of today’s American society. Modern family circumstances and dynamics have become very different than they were 25 or 50 years ago. Today, more than half of all children will spend some time growing up in a non-traditional family structure such as one with a single parent, a grandparent or other relative, or a co-habiting couple. Moreover, significant growth in the on-demand or “gig economy” has changed the structure of small businesses and sole-entrepreneurships. Yet, the tax code has not kept pace with the changes in our family or economic structures, and needs to modernize to catch up. There are also multiple definitions of income under the code, which also contributes to confusion. For simplification reform to be meaningful, the social and economic changes that have taken place in the individual, family and small business tax base have to be taken into account for the future.

In a study published last year by Elaine Maag, H. Elizabeth Peters, and Sara Edelstein of the Tax Policy Center, the authors found that over 90 percent of all families with children could benefit in some way from the range of provisions like the earned income tax credit (EITC), the child tax credit (CTC), or other personal and dependent exemptions, but many families simply do not understand what they qualify for because they do not know who in their family qualifies as a dependent, or who the custodial parent might be under the code. There are often multiple definitions of a term in the code, and many times they are not only confusing but conflicting. Simplifying terms and streamlining qualification criteria so taxpayers can better understand their eligibility can spell the difference between owing money or receiving a deserved refund. Moreover, excessive complexity can make credits susceptible to inaccuracy and error.

The labyrinth of existing tax rules does not mesh easily with how people actually live their lives today, leaving opportunities for error and omission. Inaccuracy of claims by lower income

working families can often be traced back to confusion and lack of understanding about basic eligibility. But the same can be said for savings vehicles for retirement and education. Excessive complexity is a barrier to achievement of the very economic policy objectives -- such as savings or a better economic quality of life -- that Congress set about to achieve through tax incentives in the first place. The tax code needs to be sufficiently simplified that taxpayers can understand what financial decisions they may make going forward that could minimize their tax bills, optimize their refunds, or, more generally, improve the financial lives of themselves and their families.

The tax preparation industry is poised to work with Congress to continue to simplify the tax compliance and e-file experience. We will continue our collaboration to eliminate and reduce e-file rejects and remove barriers to facilitate small business e-filing. E-payment and other transactions are also enabled via technology. Through tax simplification, Congress should also ensure that IRS begin accepting electronic records as a satisfactory, or even preferred, form of record keeping. It not only comports with Congressional intent to reduce paperwork on small business, but it also directly correlates to the increased use of technology in which today's modern family businesses operate.

Public-Private-Partnership

The history of constructive collaboration between the public and private sectors in service to the taxpayer is significant, and needs to be applied now again in the drive to ensure tax simplification reform.

Electronic Filing

The first major public-private-partnership was the collaboration between the IRS and the tax and technology industries to achieve public adoption of electronic filing as the preferred method of tax compliance in the United States. The dramatic growth over a little more than a decade from a national e-filing rate from a little over 10% to the current 88% of all individual tax returns is a transformative change in the American tax system and quantum improvement in its efficiency, cost-effectiveness and accuracy.

The American e-filing partnership represented a division of labors between the public and private sectors, where the Government was able to focus on modernizing its systems and its tax administration technologies, while industry invested in electronic filing infrastructure and platforms, applying its expertise not only through its continually evolving technology innovation but through its marketing and customer service expertise. The result is that e-filing today has become the return submission methodology for nearly 90% of all individual income tax returns.

IRS Free File Program

At the beginning of his Administration, President George W. Bush wanted to ensure that American taxpayers of modest means had a free way of electronically preparing and

filing their tax returns. The then-IRS Commissioner proposed an innovative public-private-partnership to seek a non-monetary agreement with the private sector technology and tax products and services industry, whereby the industry would make private sector tax compliance innovations available to eligible taxpayers through the IRS website at no cost to either the Government or the end user. That Negotiated Public Rulemaking of October 2002 created the IRS Free File Program, which provided first service 90 days later, in time for the start of the 2003 tax season.

Over the last 15 tax seasons, the private sector Free File Alliance has donated more than 50 Million tax returns and e-filings to American taxpayers through the Free File Program, operating under a set of standards, requirements and consumer protections governed by the IRS. This public-private-partnership has been a singular, award-winning achievement in the *electronic government* space, while preserving the American system of Voluntary Compliance.

And beyond the 50 million free tax returns that have been donated by the private sector through Free File, you can also measure the results of this public-private-partnership through the estimate that the Government has saved Hundreds of Millions of dollars through operating cost reductions, the taxpayer has saved in excess of \$1.5 Billion in individual and family tax compliance costs, and the public Treasury has saved estimated additional Billions of dollars over the last fifteen years by foregoing using public funds to attempt to duplicate the range of private sector innovations and services in tax compliance by trying to create the government's own tax preparation and e-filing products and services. All of these savings were made possible due to the innovative public-private-partnership known as Free File.

The IRS Security Summit and ISAC

Over the last several years, a growing threat to Government and the Private Sector has been the emergence of global cybersecurity attacks and resulting cyberfraud. The theft of massive amounts of personal identity information from both Public and Private databases of various kinds obtained through breaches on the Web over the last several years has made targets of both the Government and Private Sector for outside electronic attacks. These external malicious actors weaponize the identities they stole or purchased off the Web to attempt to perpetrate Account Takeover Attacks (ATOs) or Stolen Identity Refund Fraud (SIRF), using the data to try to create new tax accounts, masquerading as legitimate taxpayers.

In March 2015, the IRS Commissioner convened a new public-private-partnership between the Federal Government, State Governments and the Private Sector -- including the tax, technology, payroll, and financial services industries -- to fight cyberfraud. Known as the IRS Security Summit, this collaborative process has created a code of requirements and standards to defend the American tax system against cyber theft, and to date has slashed IRS cases of reported Identify Theft Refund Fraud by more than 50%. And the IRS has focused the Electronic Tax Administration Federal Advisory Committee to carry on the work of the Security Summit long term, because the fight against

cyberfraud will be a long, twilight struggle, which will require commitment and persistence on the part of the collective tax ecosystem. And to take that fight to the next level, the Security Summit has also created an Information Sharing and Analysis Center – a tax ISAC – as the next phase of the public-private-partnership to ensure a proactive, long-term strategic defense of the American tax system.

These three examples of public-private-partnership within the US tax system represent a proven and economically efficient strategy of success, while defining a division of labors between public sector tax administration and enforcement, and the inventions and innovations of the private sector tax, financial and technology industries. Together, this tax ecosystem also defines the strength of the quintessentially American system of Voluntary Compliance.

As policymakers now contemplate tax simplification reform, it will be important that these divisions of labor and productive collaborations be preserved and strengthened. The alternative emergence of duplicative taxpayer services, data systems, individual accounts and other related initiatives by Government would unnecessarily create more complexity, not less. For simplification to be meaningful for the American taxpayer, the Public and Private Sectors each need to do what they do best.

The Taxpayer Advocate has offered cautionary counsel as policymakers consider the *Future State* of the U.S. tax administration. It is important that the *IRS Future State* focus on those core, essential capabilities that it uniquely contributes to the American tax system. Government should continue to rely on the private innovation sector for those taxpayer service capabilities that are most efficiently and effectively created and provided from the private sector's wheelhouse, such as e-filing amendments, transcript delivery, handling notices, just to name a few. These principles make simple economic sense in terms of prudent application of limited Public resources. Government investment in overlapping or duplicative systems and service offerings would create added complexity and increased confusion for taxpayers. And so, in seeking to achieve simplification reform in the American tax system, a key principle for policymakers must be to ensure that the *Future State* of the American tax system continue a clear division of labors in the differentiated roles and contributions of the Public and Private Sectors respectively, each doing what it does best. The taxpayer already trusts their tax service relationships and can understand the different roles played by each party in the ecosystem. That clarity about the division of labors and resources in the tax system is important to public confidence in, and understanding of, the fairness and objectivity of that tax system.

Future Public-Private-Partnership

There has been much talk in the public square about creation of simplified Post Card Tax Return. Obviously, in the modern environment of electronic filing and electronic tax administration, we are really talking about an Electronic Post Card. And of course, electronic filing of a future Post Card return will mean that it will fully benefit from the many modern safeguards already adopted by the IRS Security Summit process, which protect both the taxpayer and the tax system.

But the key message that the tax, technology and financial product and service industries wish to convey with clarity today is that continued innovation to simplify and reduce the burdens of tax

compliance is already a future that the Private Sector is deeply committed to. The innovative capabilities of the technology and tax services sector will be applied in a continued environment of intense competition and rich consumer choice.

Creating a simplified Electronic Post Card Return is an innovation opportunity this industry welcomes and will embrace if that is the direction policymakers take.

And in this regard, we ask policymakers to keep in mind that the Government and Industry each will require some time to fully implement the reforms and changes you may make in the tax code. We would urge that policymakers not wait to the end of the year to make its final decisions. A smooth, effective, and innovative new Tax Season will require some time to deliver, particularly if a substantial amount of change is adopted. So the bottom line of our message in this regard is that policymakers need to begin with the end in mind, and allow sufficient time for rigorous and well-tested implementation to be put in place, all of which is in service to a high quality taxpayer experience.

The industry is poised to collaborate with Congress and the IRS and help facilitate and enable tax simplification reform.

Thank you for the opportunity to contribute our thoughts, and we will be happy to respond to any questions you may have.



Chairman ROSKAM. Mr. McKay, let's do this, we can continue to inquire and we are going to be able to get to, I think, the rest of the basis of your testimony.

So Ms. Stout.

**STATEMENT OF JANIA STOUT, PRACTICE LEADER AND
CO-FOUNDER, FIDUCIARY PLAN ADVISORS AT HIGHTOWER**

Ms. STOUT. Thank you, Chairman Roskam, Ranking Member Doggett, and Members of the Tax Policy Subcommittee for the opportunity to speak with you about the importance of tax incentives for retirement savings.

My name is Jania Stout. I'm the Practice Leader and Co-Founder of Fiduciary Plan Advisors. Fiduciary Plan Advisors is an independently owned provider of fiduciary advice to retirement plan sponsors and their hard-working employees.

I bring more than 20 years of experience in retirement plan consulting for plans of all sizes. I advise 140 retirement plans, covering approximately 50,000 employees and \$2.4 billion in retirement savings.

I also serve as Vice President of the National Association of Plan Advisors. NAPA is the voice of the retirement plan advisory community and is part of the American Retirement Association.

The message I want to convey today is that the current tax incentives are working very well to promote good savings behavior for tens of millions of American workers. Seventy-five percent of households have access to a workplace retirement plan, and 82 percent of them are participating.

The most important factor in determining whether workers save for retirement is access to a workplace retirement plan. Moderate-income workers are 15 times more likely to save if they have a plan at work versus less than 5 percent save in an IRA if left on their own.

Tax reform proposals that freeze retirement contribution limits and cap the exclusion for retirement contributions will discourage small businesses from offering retirement plans. I recommend to all my clients that they offer both a Roth and a pretax contribution option in their plan design. A Roth option can be beneficial for millennials and lower wage earners.

Having the choice is important. We have even started discussing with our clients the option of doing an automatic enrollment into a Roth source. However, any policy move toward more reliance on Roth contributions must be accompanied by other changes to the tax incentives to expand coverage and benefit security.

Expanding workplace plan coverage is critical to building retirement security for the middle class. To this end, I support proposals, such as increasing the retirement plan startup tax credit and adding a credit to encourage automatic enrollment.

In addition, I support the pooling of unrelated employers into a single plan, an idea proposed by Congressman Buchanan, Neal, Renacci, and Kind. Pooling plans will produce economies of scale by lowering both employer and plan participant cost, which will boost retirement plan coverage.

The most significant reduction in retirement security is associated with the cash-outs that often occur during a job change. I

have helped hundreds of participants figure out how to roll over their retirement savings from an old employer into their new employer's plan.

To address this challenge, I support recommendations regarding authorization of a national retirement clearinghouse which would facilitate consolidation of retirement accounts when employees change jobs.

In addition, the Committee should consider Congressmen Johnson and Neal's SEAL Act, which permits individuals to continue to repay plan loans if a participant becomes unemployed or their retirement plan is terminated.

A Medicare-eligible couple at age 65 will need at least \$260,000 in savings for healthcare in retirement. Health savings accounts are the best way to save for this expense. To this end, we propose providing plan sponsors the option of adding an HSA feature to their 401(k), as Congress did when it allowed 401(k) providers to add an IRA to their plan in 2001. Integrating HSAs into the 401(k) in this fashion has the benefit of providing participants with access to lower cost investments offered in the 401(k) and holistic financial advice for savings for both health and retirement needs.

I applaud this Committee's work to make tax rates on small businesses more competitive by reducing the tax on pass-through income. In that spirit, I want to highlight a technical issue related to small business retirement plans. It is critical that retirement plan contributions by shareholders or partners of pass-through entities be deducted only against the income that is classified as reasonable compensation. The value of offering a retirement plan to employees is preserved when the tax rate related to the deduction matches the tax rate the employee will pay when they retire.

Thank you again for the opportunity to participate in this important discussion. I would be pleased to discuss these issues further with the Committee and answer any questions you may have.

[The prepared statement of Ms. Stout follows:]

Testimony of Jania Stout
Practice Leader and Co-Founder of Fiduciary Plan Advisors at HighTower
House Ways & Means Subcommittee on Tax Policy
Hearing on How Tax Reform Will Simplify Our Broken Tax Code and Help
Individuals and Families
How to Best Promote Retirement Security through the Tax Code
July 19, 2017

Thank you Chairman Roskam, Ranking Member Doggett and members of the Tax Policy Subcommittee for the opportunity to speak with you about the importance of the tax incentives for retirement savings and our workplace-based retirement plan system. My name is Jania Stout and I am a Practice Leader and the Co-Founder of Fiduciary Plan Advisors at HighTower. HighTower is an independently owned, registered investment advisory firm led by a partnership of experienced investment professionals with their own established practices. I bring more than 20 years of experience in retirement plan consulting to the organization. My professional practice is located in Owings Mills, Maryland where I advise about 140 retirement plans. Approximately 50,000 employees have \$2.4 billion in assets invested in my plans. My clients — located mainly on the East Coast — range from small businesses with 5 to 20 employees to larger employers with 10,000 to 15,000 employees.

I also serve as Vice President of the National Association of Plan Advisors (NAPA). NAPA is the voice of the retirement plan advisory community and its mission is to improve transparency, effectiveness and governance of workplace-based retirement plans to enhance retirement outcomes for participants. NAPA is one of the premier retirement industry associations that is part of the American Retirement Association (ARA). The ARA is a non-profit professional organization with more than 22,000 members nationwide. The ARA has two key missions: to educate and inform retirement benefits professionals like myself, and to advocate for policies that give every working American the ability to have a comfortable retirement.

A major objective of tax reform is to provide long term economic growth to build financial security for the middle class. The current tax incentives that underpin workplace-based retirement plans achieve this objective by enabling good savings behavior for the tens of millions of Americans who participate. This critical savings component results in \$67 trillion or 59% of the non-bank financial capital provided to the equity and bond markets.¹ Tax reform is a once in a lifetime opportunity to simplify the retirement plans rules and expand retirement plan coverage in the workforce that will build even further on this success. Increasing retirement savings would increase long-term economic growth by 3% or \$3,500 per person over the next 25 years.²

¹Oxford Economics, *Another Penny Saved: The Economic Benefits of Higher US Household Savings*, (June 2014), available at: <http://www.oxfordeconomics.com/anotherpennysaved>

²*Ibid.*

Reducing the tax incentives — like freezing the retirement plan contribution limits that are currently indexed to inflation or capping the retirement savings exclusion rate for individuals in certain income tax brackets — would be the wrong way to go. Reducing the incentives in these ways would discourage small business owners from offering and contributing to workplace-based retirement plans. The result would be fewer retirement plans and lower employer contributions for rank-and-file employees, putting the retirement security of middle class Americans at risk and undermining long term economic growth.

Workplace Plans are the Foundation for A Secure Retirement

The tax incentives for retirement savings are unique in that the tax incentive is a deferral, not a permanent exclusion — so every dollar that is excluded from income this year will be included in income in a future year. The tax incentives for employer-sponsored retirement plans are also unique in that the nondiscrimination rules, coupled with dollar limits on contributions and a limit on the amount of compensation that can be included in determining benefits, assure that the plans do not unduly favor highly compensated employees.

The current system of tax incentives that powers workplace retirement plans has been successful at accumulating a large amount of assets to improve the retirement security of tens of millions of American households. Seventy-seven million households — 61 percent — have an employer-sponsored plan or an individual retirement account (IRA). At the end of 2016, private employer-sponsored defined contribution plans held about \$7 trillion in assets, private employer-sponsored defined benefit plans held \$2.9 trillion and state and local retirement plans held \$3.9 trillion. Another \$7.9 trillion is held in IRA accounts. Although IRAs include contributions made by individuals to the IRA on their own behalf, a substantial portion of IRA contributions are attributable to rollovers from employer-sponsored plans and direct employer contributions. Together, defined contribution plans and IRAs comprise 59 percent of retirement assets.³

Data show that 401(k) and similar plans — such as 403(b) and 457 arrangements — have been successful in getting workers to save for retirement. The most important factor in determining whether workers across the income spectrum save for retirement is whether there is a workplace-based retirement plan. Contrary to the common assertion that only half of working Americans are covered by a retirement plan, a recent update of a study from the Social Security Administration shows that 75 percent of private-sector workers have access to a retirement plan at work, and 82 percent of eligible workers with access to a plan participate in the plan.⁴ The success of saving through a workplace-based retirement plan extends to moderate-income workers. More than 70 percent of workers earning \$30,000 to \$50,000 participate in a plan at work, but fewer than 5 percent will save through an IRA on their own (see chart one).⁵ These plans primarily benefit the middle class: 68 percent of active participants in 401(k) plans have an adjusted gross income (AGI) of less than \$100,000 per year. Thirty-five percent of participants have an AGI of less than

³Investment Company Institute, *2017 Investment Company Fact Book: A Review of Trends and Activity in the Investment Company Industry*, available at: http://www.icifactbook.org/ch7/17_fb_ch7

⁴Irena Dushi, Howard M. Iams, and Jules Lichtenstein, *Retirement Plan Coverage by Firm Size: An Update*, Social Security Bulletin (May 2015), available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2604116

⁵Employee Benefit Research Institute (2010) estimate using 2008 Panel of SIPP (Covered by an Employer Plan) and EBRI estimate (Not Covered by an Employer Plan – IRA only)

\$50,000 (see chart two).⁶ Americans earning between \$25,000 and \$75,000 save seven times more in retirement savings than any other type of savings.⁷

Chart One

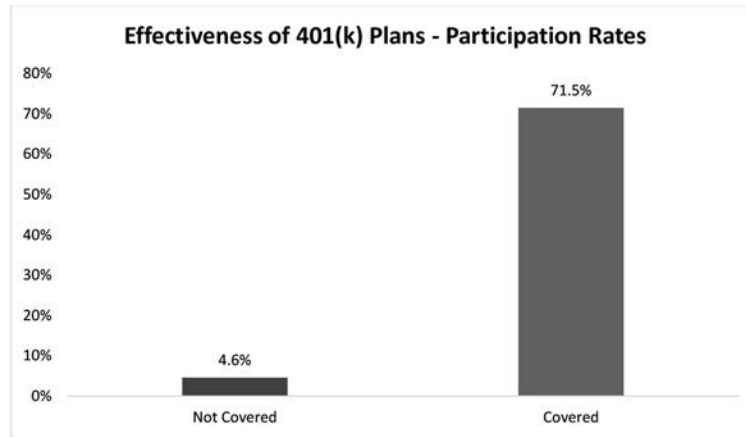
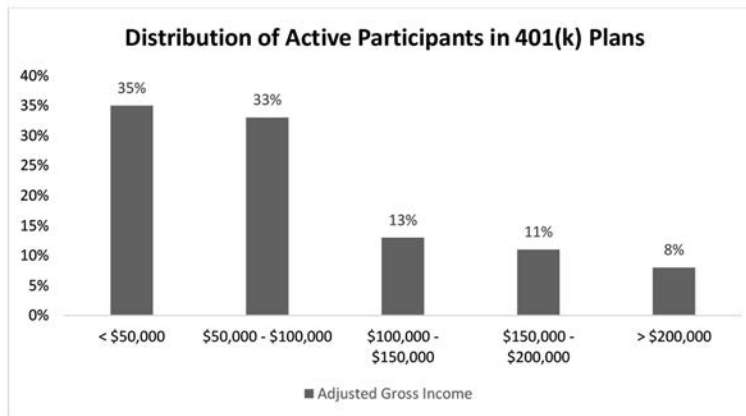


Chart Two



⁶Internal Revenue Service, Statistics of Income, IRA Studies, 2014

⁷Employee Benefit Research Institute estimate of the 2013 Survey of Consumer Finance

Participants Value Tax Treatment Choice

Seventy-six percent of employers that sponsor a qualified retirement plan offer both traditional pre-tax contributions and Roth after-tax options to employees.⁸ When I meet with plan sponsors, I always recommend to them that they include an after-tax or Roth savings option within their plan in addition to the traditional pre-tax savings option. In my experience, most employers agree to add the option in their plan design, but there are still some employers that are reticent to take that step.

Under Roth contributions, employees pay income tax currently on their contributions with the promise that their earnings on their account will be distributed tax-free at retirement. In most cases, employees can allocate all or a portion of their contributions to their employer's plan into these accounts. Like traditional pre-tax contributions, Roth contributions also offer tax incentives to employees to motivate them to contribute. This feature is especially attractive to Millennial savers in the early stages of their working career, when their income tax liability is expected to be relatively low and the money saved in the account is expected to earn the most interest over time. Furthermore, Roth contributions and earnings are also exempt from required minimum distributions beginning at age 70 ½. This proves to be an important planning tool for many retirees. While Roth contributions comprise a smaller percentage of overall 401(k) contributions, they are growing in popularity. I think that participants should enjoy the widest array of options with a workplace plan so they can make a decision that is best for them. Any policy move toward more reliance on Roth contributions must accompany other changes to the tax incentives to continue to motivate both the employer to sponsor a workplace-based retirement plan and the employee to contribute to it.

Expanding Workplace Retirement Plan Coverage

If increasing the financial and retirement security of American families is the goal, increasing the availability of workplace savings plans is the way to get there. By making it easier and more meaningful for a small business to adopt a workplace retirement savings plan, access to saving through payroll deduction will increase.

I support proposals that will both enhance the incentives for and simplify the administration of workplace-based retirement savings plans. Increasing the pension plan startup tax credit would further reduce the cost to new small businesses that choose to sponsor qualified retirement plans for their employees. Adding an additional credit to encourage the automatic enrollment of those workers into both new and existing plans will increase the number of workers saving.

I applaud Congressmen Buchanan, Neal, Renacci and Kind for introducing the Retirement Security for American Workers Act (H.R. 854). H.R. 854 expands retirement plan coverage by allowing two or more unrelated private employers to join a pooled employer retirement plan. Importantly, the legislation requires the provider of such an arrangement to take responsibility for the proper operation of the plan. The clear lines of responsibility prescribed in the legislation give adopting employers — many of which could be small business owners — more security. Additionally, adopting employers will not have to worry about the actions of one participating

⁸Plan Sponsor Council of America, *Tax Reform Impact on DC Plans* (June 2017), available at: https://www.pzca.org/Snapshot_Roth

employer disqualifying the plan for all the other employers. Furthermore, H.R. 854 allows retirement plan providers to offer a payroll deduction IRA program with automatic enrollment through a pooled employer plan to small business owners. Pooling unrelated employers together into one plan creates economies of scale that lower both employer and plan participant cost, which will ultimately boost retirement plan coverage in the private sector.

In this digital age, it remains frustrating to me that retirement plan disclosure rules remain stuck in the 20th Century. Retirement plan participants must still receive these notices on paper unless they affirmatively choose to receive the disclosures electronically. The result is a lot of wasted business time, expense and paper. Fortunately, Congressmen Polis, Roe, Kelly, and Kind introduced the Receiving Electronic Statements to Improve Retiree Earnings (RETIRE) Act in the last Congress that would update these rules for the 21st Century. The bill would allow for these disclosures to be furnished electronically as the default while protecting individuals who still wish to receive information about their retirement benefits on paper. According to a recent study, switching to an electronic delivery default would produce \$200 to \$500 million in aggregate savings annually that would accrue directly to retirement plan participants.⁹ These lower expenses would lead to higher net investment returns for participants and allow these notices to be provided in a more interactive and useful way.

How to Minimize Workplace Retirement Plan Leakage

A special area of concern of mine involves pre-retirement distributions from retirement accounts or “leakage” as we call it in the industry. The Employee Benefits Research Institute (EBRI) found that approximately two-thirds of the impact of diminished retirement savings due to leakage was associated with the cashouts that sometimes occur at job change.¹⁰ In addition, a Transamerica survey found that 25 percent of workers in small companies either take a loan or cash out part of their retirement savings for a variety of non-retirement purposes.¹¹ Other workers simply leave their small balance retirement accounts behind when they change jobs. Confronted with the pressures of everyday life, it is easy to lose track of many small accounts. This seriously jeopardizes the retirement security of millions of Americans. Sadly, the current structures make it difficult and time consuming for individuals to keep their retirement savings in retirement accounts.

We need to find an easier way for participants to rollover their existing retirement savings into the new employer’s plan when employees change jobs. I help hundreds of retirement plan participants every year with this daunting and time-consuming task. The good news is there are a handful of simple legislative fixes that can help solve this problem. I support the recommendations from both the Bipartisan Policy Center and the ERISA Advisory Council that propose the authorization of a national retirement security clearinghouse to streamline transfers

⁹ Quantria Strategies prepared for The SPARK Institute, *Improving Outcomes with Electronic Delivery of Retirement Plan Documents* (June 2015), available at: http://www.sparkinstitute.org/content-files/improving_outcomes_with_electronic_delivery_of_retirement_plan_documents.pdf

¹⁰ Jack VanDerhei, *The Impact of Leakages on 401(k) Accumulations at Retirement Age*, ERISA Advisory Council (June 17, 2014), available at: www.ebri.org/pdf/publications/testimony/T-180.pdf

¹¹ Transamerica Center for Retirement Studies, *17th Annual Transamerica Retirement Survey: A Compendium of Findings About American Workers* (December 2016), available at: https://www.transamericacenter.org/docs/default-source/retirement-survey-of-workers/tcrs2016_sr_retirement_survey_of_workers_compendium.pdf

and rollovers among workplace-based retirement plans and IRAs. With this new rollover infrastructure in place, we can leverage the lessons of behavioral finance and automatically transfer retirement assets with the worker — from a former employer’s retirement plan to their active account in a new employer plan — when workers change jobs. This process is called auto-portability. With auto-portability, workers will now be able to easily consolidate their retirement accounts and more quickly grow their retirement assets.

Second, the Committee should consider Congressmen Johnson and Neal’s Savings Enhancement by Alleviating Leakage in 401(k) Savings or SEAL Act. The SEAL Act permits individuals to continue to pay plan loans if a plan is terminated or a plan participant becomes unemployed. This reduces the risk that the employee will default on his or her plan loan and suffer taxes and penalties on his or her retirement savings. The legislation also modifies the hardship distribution rules to allow participants to make additional contributions to a plan during the six-month period following a hardship distribution.

As the Committee considers increases to restrict leakage from workplace-based retirement plans, it is important to be mindful of the tension between restrictions on distributions and the willingness of workers to save. If access to these assets in true emergency situations is too restricted, some may be reluctant to save in the first place.

Integrate Health Savings Accounts (HSAs) with 401(k) Plans

As this Congress is considering expanding health savings accounts (HSAs) as part of the healthcare legislation, we need to further integrate these accounts into the market to improve employees’ understanding and utilization of them. Today, HSAs are largely treated separately from retirement savings accounts. According to a Fidelity analysis, a healthy Medicare-eligible couple age 65 will need at least \$260,000 in savings for health care in retirement.¹² Help with these important savings decisions becomes more critical if Congress expands HSAs as part of health care or tax reform.

To address this need, I propose modifying the tax code to give plan sponsors the option of offering an HSA as a “sidecar” account to their 401(k) plans. Congress included a similar provision allowing plan sponsors to add a “deemed” or sidecar IRA to their 401(k) plans in the 2001 tax bill. As someone who works with thousands of employees a year to help them with their savings decisions, it makes the most sense for employees to be able to make the 401(k) and HSA contribution decisions together, on a holistic basis. Integrating HSAs into the 401(k) in this fashion has the added benefit of providing participants with access to lower cost investment options offered in the 401(k) plan. In addition, the proposal will spur the development of financial advice tools that will help employees make savings decisions that best fit the financial and health needs of their families. And last, the HSA sidecar proposal preserves all of the unique characteristics of HSAs under current law to keep things simple.

¹²Fidelity Investments, *Health Care Costs for Couples in Retirement Rise to an Estimated \$260,000, Fidelity Analysis Shows – Long-Term Care Insurance Could Add an Additional \$130,000* (August 16, 2016), available at: <https://www.fidelity.com/about-fidelity/employer-services/health-care-costs-for-couples-in-retirement-rise>

Pass-through Tax Rate Caps Could Eliminate Small Business Retirement Plans

I applaud this Committee's work on tax reform. It is long overdue and we offer our support and help. I also applaud this Committee's work to make the tax rates on small businesses more competitive by reducing the tax on pass-through income. In that spirit, I do want to raise an important technical issue related to retirement plans. As you develop a proposal related to the taxation of pass-through entities, it is critical that any retirement contributions (whether deferrals, matches, profit-sharing, or defined benefit) allocable to the partner or subchapter S shareholder be deducted directly against only the amount of income that is classified as reasonable compensation. Otherwise, the small business owners' incentive for contributing and frankly having the plan in the first place would go away since distributions from the plan would be taxed at a higher, ordinary income tax rate. In other words, the value of having a retirement plan goes away for the small business owner unless the tax rate value of the deduction matches the tax rate he or she will pay when the money is later distributed. The issue is easily resolved by making sure in both cases this is at ordinary income tax rates.

Helping Millennials Achieve a Secure Retirement

Millennial workers comprise the largest generation of American workers. As an advisor, I work with them every day with the goal of helping them establish good financial and retirement savings habits, which I hope will last a lifetime. Saving early in one's working life takes advantage of the power of earnings compounding. Waiting to save later in life puts one at a serious disadvantage because it is so difficult to catch up.

As I mentioned above, when I design plans for employers with Millennial workers I recommend adding a Roth contribution feature to their 401(k) plans along with the traditional pre-tax feature. This is because Millennial workers can accumulate larger 401(k) account balances by electing Roth after-tax contributions with their accounts. Roth contributions require employees to pay tax on their contributions up front with the promise of tax-free withdrawals at retirement. This makes sense for Millennial workers because their tax rate will be the lowest in their early working life. In fact, I have been recently working with some plan sponsors with large Millennial workforces to modify their auto-enrollment so that workers are automatically enrolled into Roth 401(k) accounts versus pre-tax 401(k) accounts.

In addition, I support a proposal that aims to solve another vexing issue for Millennial workers — student loan debt. The proposal — included in Senator Wyden's Retirement Improvements and Savings Enhancements (RISE) Act discussion draft — would allow employees to receive employer matching contributions into 401(k) plans for making student loans payments. Paying student loans would be treated like a 401(k) contribution so they do not miss out on the "free money" on the table that represents the employer's matching contribution.

And last, I see many younger workers moving between contract worker and full-time employee status — a trend that has become more pronounced in the so-called "gig economy." Modifying the 401(k) rules to allow contract workers to make their own contributions to their contractor's retirement plan without jeopardizing the plan's tax status makes a lot of sense for today's economy.

Simplification not Consolidation

Finally, a discussion of simplification has sometimes led to talk of retirement plan “consolidation.” For example, a 2004 Bush Administration proposal would have eliminated the different kinds of employee savings plans — 401(k), 403(b), and 457 plans — and replace them with a single “401(x)” plan. I would caution against tax reform proposals like this that would consolidate all the different types of defined contribution plans into a single type of plan. That would not be a simplification in my view. Each of these plans are designed to meet the needs of the various employer sectors for which they were designed. These employers need the flexibility afforded by these alternate designs.

Improved retirement security, and meaningful simplification, will be accomplished through thoughtful modifications to the existing structure — like the above proposals — without wasting resources on cosmetic overhauls that produce pain rather than savings gain.

Summary

To summarize, the current workplace-based retirement system is working well for tens of millions of working Americans. That said, more can definitely be done to make it easier for small businesses to offer retirement plans and for American workers to save in these plans. I look forward to working with the Committee to simplify the rules and regulations surrounding the tax incentives to save for retirement through workplace-based retirement plans.

Thank you again for this opportunity to participate in this important discussion. I would be pleased to discuss these issues further with the Committee and answer any questions that you may have.



Chairman ROSKAM. Thank you, Ms. Stout.

Mr. Rodriguez, I let the majority witnesses go over a little bit, so feel free to stretch your legs. You know what I am saying.

STATEMENT OF ERIC RODRIGUEZ, VICE PRESIDENT, OFFICE OF RESEARCH, ADVOCACY, AND LEGISLATION, UNIDOSUS

Mr. RODRIGUEZ. Well, I appreciate that. Thank you very much.

Mr. Chairman, Congressman Doggett, and, of course, I want to acknowledge our champion of our community, Congresswoman Sánchez for providing a lot of leadership on these issues and connecting it to the real lives of all Americans but certainly Latino Americans.

Thank you for inviting me today to appear this afternoon on behalf of UnidosUS. For those of you who don't know, UnidosUS, it is formally the National Council of La Raza. That is our new name. So I appreciate the opportunity to be here.

For over 2 decades, I have worked on economic security, poverty issues in the Latino community, and this particular topic is very important and, of course, very timely. As you know, the Tax Code has considerable influence over the economic security and mobility of workers. And a lot has changed since 1986.

For instance, at that time, Latinos represented just 8 percent of the total U.S. population. Today, Latinos represent 17 percent of the U.S. population. Today, Latinos are at 56 million strong and growing throughout the country. But at the same time, Latinos are twice as likely to be in poverty than their white peers, and income and wealth gaps remain quite wide.

For instance, in 2013, the average Latino family had just \$1 for every \$10 in the average white person's household. A congressional rewrite of the Tax Code stands to either improve or worsen economic and wealth disparities for these households.

Moreover, as a previous witness has mentioned, millennials are very important as we look out to the future. Sixty percent of Latinos are millennials or younger. And how tax policy affects them and influences their economic behavior will have complicated implications for the long-term viability and prosperity of the Nation.

For these reasons, I am very pleased to be here and represent our perspective on tax reform proposals currently under debate.

As you know, the Federal income tax is intended to collect revenue to fund important public goods and services. These include defense, veterans affairs, healthcare, public education, infrastructure, and safety net, and environmental protections, among many other public goods that we all enjoy.

The Tax Code can also raise incomes of working-class Americans while delivering economic growth, but only if lawmakers are intentional about centering the benefits of reforms on middle class working families and individuals.

Over 90 percent of Latino voters we recently polled favor tax incentives to help them buy homes, go to college, save for retirement, or just make ends meet. Whatever we do in tax reform ought to start with ensuring that revenue is adequate to meet these needs and that tax reforms are equitable for all taxpayers.

Recent tax proposals from the Administration and House Republicans threaten to weaken the government's ability to protect and serve taxpayers and will unfairly benefit the wealthiest.

As it stands, too much of the roughly \$700 billion in tax expenditures the government currently spends help the rich get richer, through targeted deductions, preferential tax rates, and other tax breaks.

Proposals that aim to inflate those benefits at the cost of workers are very concerning to us. Specifically, the Trump administration intends to pay for proposed tax breaks through budget cuts on programs that help American taxpayers. The Trump plan would result in over \$5 trillion, at least, in lost revenues in the first decade.

In the absence of credible ways to pay for these breaks, the Administration's budget framework funds these at least in part by cutting funding for crucial programs that support families.

Both the Trump and House tax proposals would accelerate the growing wealth divide. These tax plans would provide massive tax breaks to the wealthiest at the expense of middle class and working families. They have no inheritance tax, no alternative minimum tax, generous pass-through rates, and a list of tax breaks for a small number of ultra wealthy individuals while few benefits go to the middle class and working families.

There is no question that tax reform is overdue and that plans for a reform should do more for working class taxpayers. To make sure we arrive at that system, deliberations must be transparent, have to be bipartisan, and include a broad range of perspectives and voices.

Inclusivity is more important than ever as the face of America changes. In 2044, 14 States across the Nation will be majority minority. An American consensus on tax reform that includes the perspectives of diverse stakeholders and reflects shared values about tax and spending policies is our best chance at establishing a modernized system that will stand the test of time.

Accordingly, tax reform proposals ought to raise sufficient revenue to build a strong economy and invest in our future, are progressive and ensure that everyone, including the wealthy and corporations, pay their fair share; support working families and children; and reduce poverty; and promote economic mobility and asset building among middle class and working families.

In sum, tax reform is needed and important to all middle class and working Americans, including Latinos. But no tax reform plan should make our government weaker or worsen the economic and wealth divide among American taxpayers.

The path to reform ought to be a transparent and bipartisan process, a process that incorporates the views of taxpayers of all walks of life. Thank you for the opportunity to share these views. I look forward to your questions.

[The prepared statement of Mr. Rodriguez follows:]



LEVELING THE PLAYING FIELD: THE EFFECT OF THE TAX CODE ON INEQUITY

Presented at

"The Hearing on Individual Tax Reform"

Submitted to

U.S. House of Representatives Subcommittee on Tax Policy

Submitted by

Eric Rodriguez
Vice President
Office of Research, Advocacy and Legislation
UnidosUS
Raul Yzaguirre Building
1126 16th Street, NW, Suite 600
Washington, DC 20036-4845

July 18, 2017

Introduction

Chairman Roskam, Ranking Member Doggett, and members of the subcommittee, thank you for inviting me to appear this morning on behalf of UnidosUS (formerly National Council of La Raza). For over twenty years I have worked on anti-poverty and economic security issues on behalf of the Latino community, and I am pleased to be here today to share our concerns about the direction of current tax reform proposals being debated in Congress. Individual tax reform can raise the incomes of working class American families while delivering economic growth, but only if lawmakers are intentional about centering the benefits of reforms on middle-class and working families and individuals. Congressional tax reform comes once in a generation. Since the last Congressional tax reform in 1986, the Latino community has grown to more than 56 million people across the nation and is now over 17% of the US population. The tax code has had significant implications on the economic security and mobility of Latino workers during that time. A Congressional tax rewrite today stands to impact the economic and wealth opportunities for millions of Latinos well into the future.

UnidosUS is the largest national Hispanic civil rights and advocacy organization in the United States, an institution recognized in the book *Forces for Good* as one of the highest-impact nonprofits in the nation. We represent nearly 300 Affiliates – local, community-based organizations in 41 states, the District of Columbia, and Puerto Rico – that provide education, healthcare, housing, workforce development, free tax preparation, and other services to millions of citizens and immigrants in the U.S., annually.

UnidosUS has a long history of anti-poverty work and advocacy for a fair and equitable federal income tax system. For more than two decades, UnidosUS has actively engaged in public policy issues such as preserving and expanding the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC), fighting to ensure all individuals who pay their fair share of taxes have access to crucial tax credits that they have earned and are eligible for, and working to reorient the tax code's wealth building subsidies around homeownership, higher education, and retirement so that they can benefit more middle-class and working families, as well as communities of color.

Advancing equity within federal tax policy is crucial for all Americans, including hard-working middle-class and working Latinos raising children. The Latino community has the highest labor force participation rate in the country (66 percent) but many still struggle to make ends meet:

- The Latino poverty rate remains the second highest when compared to other racial or ethnic groups. In 2015, 21.4 percent of Latinos lived in poverty compared to 13.5 percent nationally.ⁱ
- Latinos had one of the lowest median household incomes in 2015. While non-Hispanic Whites enjoyed a median household income of \$62,950 that year, Latinos only earned \$45,148.ⁱⁱ
- In 2013, the average Latino family had just \$1 for every \$10 the average White family held in wealth.ⁱⁱⁱ

The purpose of the federal income tax system is to collect necessary revenue to fund important public goods and services. Public funding for national defense, veteran's services, homeland security, health care, K-12 public education, transportation and infrastructure, social safety net protections, food safety and environmental protection, and workforce retraining are all important investments and services that taxpayers benefit from.

Over time the federal income tax system has also evolved to incentivize economic and social behavior among taxpayers. For instance, through the tax code, the government spends close to \$700 billion in “tax expenditures” – targeted deductions, exemptions, credits, preferential tax rates, and other tax breaks – to subsidize wealth accumulation among taxpayers. Through the tax code, taxpayers are incentivized to buy homes, go to college, invest, and save for retirement.

Despite the important public and economic benefits to the individual income tax system, tax policies are not always fair and recent tax proposals tilt the playing field even further toward the wealthy and are cause for great concern. My testimony today will focus on the importance of the tax code to all middle-class and working Americans, including Latinos, our concerns with current tax proposals, and our principles for a tax reform that can benefit Americans from Main Street to Wall Street – equitably.

Latinos and the Tax Code

Latinos, a young, aspiring, and hardworking segment of the federal tax base, make up 17 percent of the current U.S. population, and by 2050 will account for one-third of the U.S. workforce, making the community an integral component of the nation’s economy. Latinos contribute in many ways to the economy – they work, they pay taxes, and participate in our economy as consumers. Latino contributions will continue to strengthen the national economy for decades to come, but only if the economic and tax playing fields are leveled. According to the Selig Center for Economic Growth, Hispanics in the US controlled \$1.3 trillion in buying power in 2015, an amount larger than the GDP of Australia.

UnidosUS has held onto this premise in serving our mission to create more opportunities for Latinos to participate in and contribute to the nation’s economy and wealth. For example, through the institution’s tax policy work, UnidosUS has fought to protect and strengthen the refundable tax credits for working families – the EITC and CTC – two powerful tools for alleviating poverty, building financial security, and boosting opportunity for working families. In 2015, UnidosUS mounted a tax campaign to help preserve key provisions in the EITC and CTC from expiring that year. By the end of the campaign, we successfully made permanent those key provisions that were at stake, and were able to help five million Latino families with nine million children keep an average of more than \$1,000 a year in their pockets.

We believe that taxpayers with similar income, who work, and pay similar amounts in taxes ought to be treated the same by our tax system. Part of the reason for an overly complex tax system is a desire by politicians to restrict tax benefits from certain classes of taxpayers, such as immigrants. For over a decade, UnidosUS has worked with Congress to stop politicians from using the tax code to punish immigrant families raising U.S. children. Millions of native-born American children with hard working immigrant parents are helped by the Child Tax Credit. We also believe that tax incentives for savings, home buying, making retirement contributions, and paying for higher education, should reach more middle-class and working families than it currently does.

Concerns with the President’s and House Republicans’ Tax Proposals

Tax proposals from President Trump and House Republicans make one thing clear: the wellbeing of middle-class and working families and individuals is not a priority. While the President promised on the campaign trail to dramatically improve opportunities for the working class in this country, we see signs that the wealthiest individuals and corporations will prosper at the expense of those same workers and their families. The tax cuts proposed by the Administration would be funded by

decimating budgets for programs that help workers maintain a basic standard of living, like nutrition assistance, housing assistance, public education, and health care. UnidosUS has three key concerns regarding tax proposals from President Trump and the House Republicans.

- ***The Trump administration has shown that it intends to pay for proposed tax breaks through budget cuts on programs that help Americans.*** The Trump tax plan would result in over \$5 trillion in lost revenues in the first decade^{iv}, and the House tax plan would lose \$3.1 trillion in revenues.^v But in the absence of credible ways to pay for these plans by limiting tax breaks or raising other revenues, the Administration's budget framework effectively pays for its tax breaks, at least in part, by cutting the budgets to crucial programs that support families struggling to make ends meet. The cuts would, for example:
 - Endanger families' health through unprecedented cuts to the Medicaid program and changes to its structure that end the program as we know it. Latinos make up 31% of those who rely on Medicaid for health care coverage.
 - Take food off kitchen tables across the country by slashing food stamps by 25%. This program helps working families, and those in between jobs, feed their families and reduce the risk of food insecurity. In 2015, SNAP provided nutrition assistance to 3.3 million Latinos, and kept 1.2 million Latinos out of poverty.
 - Eliminate funding for after school programs for low-income kids and reduces funding for higher education programs, including federal programs like GEARUP and TRIO that are aimed at helping low-income students prepare for and succeed in college. One-third of GEARUP participants and one-fifth of TRIO participants are Latino.

Lessons learned from the state of Kansas suggest that this type of tax reform does not work. In 2013, Kansas lawmakers passed a tax cut package that skewed toward the wealthy based on the premise that such reform would spur economic growth. Four years later, the economic growth that was promised never materialized. Instead, Kansas now has a budget deficit, with underfunded schools and pensions, and no money for infrastructure repairs or other public service projects.

If Congress and the administration want to improve economic opportunity and growth for Americans, they should pass comprehensive immigration reform, invest in infrastructure and workforce development, take into serious consideration constituents' fears about losing their healthcare and work to stabilize our healthcare system, and pass higher education reauthorization.

- ***Both the Trump and House tax proposals would accelerate the growing wealth divide.*** These tax plans would provide massive tax breaks to the wealthiest Americans and tilt the playing field even further in their direction at the expense of middle-class and working families.
 - Both the Trump and House tax proposals would end the estate tax, levied on only the wealthiest estates. In 2017, 99.8% of estates owe no estate tax at all because only estates worth more than \$5.49 million per person (\$10.98 million per couple) are required to pay the estate tax.^{vi} It is only the top 0.2% of wealthy estates that are required to pay, and who would benefit from the elimination of the estate tax.^{vii}

- Both the Trump and House tax proposals would also provide massive pass-through tax breaks to the wealthy. Beneficiaries of such tax breaks would include wealthy investors, hedge fund managers, bankers, executives, and lawyers – many of whom are millionaires.^{viii} A lower tax rate on pass-through business income like the one in the Trump plan would mean the 400 highest-income taxpayers would receive an average of roughly \$9 million in tax cuts in 2018.^{ix}

These proposals not only bypass hard-pressed working-class families and individuals but could ultimately worsen their financial wellbeing. The gains for the highest-income households would dwarf those of less-affluent families. Under Trump's campaign tax proposal, people with incomes above \$1 million would get a tax cut averaging \$387,000 in 2025, raising their after-tax income by 14 percent.^x Conversely, those making between \$40,000 and \$50,000 would see their after-tax income rise by just 1 percent, or \$500, on average. The House GOP tax plan will also largely benefit the wealthy. Under the House plan, people with incomes above \$1 million would receive tax cuts averaging \$302,000 in 2025, raising their after-tax incomes by 11 percent.^{xi} People making between \$40,000 and \$50,000 would receive just \$120, on average, according to the House plan.^{xii}

Such ill-advised deficit driven tax cuts would very likely leave most middle-class and working families who are the driving force behind the U.S. economy *worse* off because the large tax cuts for the very wealthy would be paid for, at least in part, by cutting programs on which they and millions of other middle-class and working families rely on to maintain a basic standard of living or during particularly tough times.

- ***Both the Trump and the House tax plans propose changes that would take money directly out of the pockets of American workers and their families.*** The proposal to double the standard deduction for single filers and married taxpayers filing jointly would not provide any tax benefits to at least 17 million working families and individuals because they do not earn enough to owe federal income taxes, even though most pay significant payroll and other taxes.^{xiii} Trump's tax plan also likely proposes to eliminate the head of household filing status and personal exemptions, which together could increase taxes for single parents.

Furthermore, President Trump proposes cutting the CTC by denying eligibility to millions of working families who honestly and accurately claim the credits under current law. This would affect roughly 5 million children – most of whom are U.S. citizens.^{xiv} Research suggests that doing so would not only increase hardship for these children, but also weaken their prospects for a healthy childhood, success in school, and ultimately their ability to contribute to the economy as adults.

Principles in Tax Reform

We believe that tax reform should work for all taxpayers, and provide sufficient money to fund vital public goods and services as well as meet the needs of an aging population. As Congress moves forward, we urge you to develop a plan that puts middle-class and working people first, and fuels upward economic mobility instead of increasing an already significant wealth divide. UnidosUS will follow the principles below when examining tax reform proposals to ensure that they:

1. ***Raise sufficient revenue to build a strong economy and invest in our future – and at the very least not lose revenue.*** A strong economy remains a paramount concern for Latinos. With sufficient revenue our country can afford to invest in – not cut – essentials like education, infrastructure, health care, and family-supporting tax credits that help our children thrive. These investments will build a strong economy and competitive workforce in the long term.
2. ***Are progressive and ensure that everyone, including the wealthy and corporations, pay their fair share.*** As a result of enacted austerity measures, middle-class and working families and children have already endured cuts to vital programs such as Head Start, education, workforce development, housing assistance and other critical services. Tax reform should ask those who are doing the best in today's economy – the wealthy and profitable corporations – to pay their fair share.
3. ***Support working families and children, and reduce poverty.*** The tax code has long been an instrument to provide critical means-tested supports to working families and children. More can be done to support working families by improving existing refundable tax credits that will further help working class taxpayers out of poverty.
4. ***Promote economic mobility and asset-building among middle-class and working Americans.*** The tax code supports asset-building through mechanisms such as deductions for retirement savings or mortgage interest, but does so in a way that disproportionately benefits those who need these least. Asset-building features in the tax code should be reformed to ensure that middle-class and working Americans also have the opportunity to save for their future, have access to affordable education, and a path to homeownership.

Conclusion

It has been over three decades since Congress reformed the tax system. There is no question that tax reform is overdue and that plans for reform should do more for working class taxpayers. The evidence is overwhelming that a comprehensive restructuring of the tax code by Congress ought to be done in a deliberative and transparent way, must be bi-partisan, and ought to include a broad range of perspectives and voices. The 1986 tax reform effort was bi-partisan, took years to complete, and included the voices of diverse stakeholders. Moreover, the experience of the enactment of the Affordable Care Act and current efforts to repeal and replace the law is a reminder of how crucial the process is – that sustainable, systemic reforms are built on consensus in the public and in Congress. In 1986, the U.S. Latino population was less than 8% of the total U.S. population, today it is more than 17%. By 2044, 14 states will be majority-minority. An American consensus on tax reform that includes the perspectives of diverse stakeholders and reflects broadly shared values about government tax and spending policies is our best chance of establishing a modernized system that will stand the test of time.

-
- i Bernadette Proctor et al., *Income and Poverty in the United States: 2015*, (U.S. Census Bureau: Washington, D.C. 2016), <https://www.census.gov/library/publications/2016/demo/p60-256.html> (accessed July 2017).
 - ii Ibid.
 - iii Amy Traub et al., *The Asset Value of Whiteness: Understanding the Racial Wealth Gap* (Demos and IASP: New York, NY 2017), http://www.demos.org/sites/default/files/publications/Asset%20Value%20of%20Whiteness_0.pdf (accessed July 2017).
 - iv *How Much Will Trump's Tax Plan Cost?*, (Committee for a Responsible Federal Budget: Washington, D.C. 2017), <http://www.crfb.org/blogs/how-much-will-trumps-tax-plan-cost> (accessed July 2017).
 - v Jim Nunn et al., *An Analysis of the House GOP Tax Plan*, (Tax Policy Center: Washington, D.C. 2016), <http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/2000923-An-Analysis-of-the-House-GOP-Tax-Plan.pdf> (accessed July 2017).
 - vi Chye-Ching Huang and Chloe Cho, *Ten Facts You Should Know About the Federal Estate Tax*, (Center on Budget and Policy Priorities: Washington, D.C. 2017), <https://www.cbpp.org/research/federal-tax/ten-facts-you-should-know-about-the-federal-estate-tax> (accessed July 2017).
 - vii Ibid.
 - viii *Pass-Through Tax Breaks Would Benefit the Wealthiest and Encourage Tax Avoidance*, (Center on Budget and Policy Priorities: Washington, D.C. 2017), <https://www.cbpp.org/research/federal-tax/pass-through-tax-break-would-benefit-the-wealthiest-and-encourage-tax-avoidance> (accessed July 2017).
 - ix Ibid.
 - x *Trump Campaign and House GOP Tax Plans Violate Mnuchin Rule*, (Center on Budget and Policy Priorities: Washington, D.C. 2017), <https://www.cbpp.org/research/federal-tax/trump-campaign-and-house-gop-tax-plans-violate-mnuchin-rule> (accessed July 2017).
 - xi Ibid.
 - xii Ibid.
 - xiii Chuck Marr, *Commentary: New Trump Tax Plan Has Specific Costly Tax Cuts at the Top, Fuzzy Promises for Everyone Else*, (Center on Budget and Policy Priorities: Washington, D.C. 2017), <https://www.cbpp.org/federal-tax/commentary-new-trump-tax-plan-has-specific-costly-tax-cuts-at-the-top-fuzzy-promises-for> (accessed July 2017).
 - xiv *Statement on Immigrant Access to Tax Credits*, (Tax Alliance for Economic Mobility: Washington, D.C. 2017), (accessed July 2017).

Chairman ROSKAM. Thank you, Mr. Rodriguez, and to all the witnesses.

Now, I will invite Mr. Reichert to inquire.

Mr. REICHERT. Thank you, Mr. Chairman.

The Chairman is very gracious in allowing Members of the panel to go before he asks his questions, and I appreciate that consideration.

Thanks to all the witnesses for being here and especially thank you to the Chairman. Mr. Chairman, you worked with my predecessor—we didn't get a chance to talk about this earlier—but Jennifer Dunn was a Member of Congress prior to my arrival. And I was honored to follow in her footsteps, as I am sure you were honored to work with her.

Mr. ARCHER. Yes.

Mr. REICHERT. And she, I know, would agree with you and I that we are at a time in history where we have the opportunity to really make a difference here in the lives of American people, all American people, all taxpaying citizens in this country, hard-working Americans.

And just as the Chairman has pointed out, the complexity of the Tax Code and, of course, your recognition and all the people on the panel's recognition of how complex the Tax Code is and at least 15,000 changes since 1986. I think your words "simplify" and "rationalize"—"rationalize" is the word that really caught me. We are looking for a rational approach to this, and "simplify."

This certainty—because I think it would provide certainty—would help Americans invest, grow, and hire across this country and provide for their families. And I am just interested in hearing from you, Mr. Chairman. What do you think permanence means for the average American worker?

So they don't really—you know, they look at the Tax Code. It is so complicated. If we can just explain permanence, because they haven't seen it for so many years. They see 15,000 additions, tax extenders, and all this other stuff going on. What does that really mean for the American people, do you think?

Mr. ARCHER. Well, I think it would depend on the economic status of each of the Americans. The more that an American has to rely or depend upon special provisions in the Code and watch them change, it is very, very bad, because, to me, you should be able to plan your life without having dramatic changes occur that are going to change everything for you and you can't anticipate it. So it depends on the condition of the individual as to the impact.

But, Congressman Reichert, one thing I intended to say in my remarks, which I ran over and I did not get to do, is that the real failing, the major failing of the effort in 1986 was the fact that there were major changes that were retroactive. And if I were to give you one caution: Do not include any retroactive provision in your tax reform. The retroactivity—and it is one of the major reasons that I led the opposition to the 1986 Tax Reform Act—undermines the value of real estate in the country and brought about the demise of thousands and thousands of savings and loans, which cost the Federal Government well over \$125 billion to correct. And that was avoidable if you simply make your changes prospective.

Mr. REICHERT. Thank you, Mr. Chairman.

Ms. Stout, quickly, Mr. Kind and I have included a related provision in our Small Businesses Add Value for Employees Act. I am referring to your testimony, the SAVE Act. How could allowing private employees to pool together to provide multiple employer private sector 401(k)s benefit both American workers seeking retirement security and small business owners hoping to provide this for their workers?

Ms. STOUT. Thank you.

I think that pooling unrelated employers would help tremendously with the coverage issues that we have. I work around the Baltimore/DC area and work with lots of small employers, and they don't have the administrative staff to be able to handle the complexity of, you know—that happens when you go to put a plan in place.

So pooling these plans together gives them the economies of scale to have lower cost so their working employees will have access to a plan, number one, but also a plan that they—that is reasonably priced, because you can pool these unrelated employers together. And I think it would make a big impact to the coverage issue we have.

Mr. REICHERT. Thank you. I yield back.

Chairman ROSKAM. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman.

And thanks to each of our witnesses.

Let me say to Chairman Archer, first, I agree with you completely about retroactive provisions, and it is unfortunate we had some included in the first tax bill we considered this year.

While you and I may differ on some aspects of tax policy, I also want to take this opportunity to thank you for your leadership in creating the Archer fellowships at the University of Texas. There is hardly a semester that goes by that I don't have one of those young people in my office.

And I know colleagues of both political parties and a number of governmental entities and nonprofit organizations have them here, and it is a great contribution to us and to each of those young people to be able to get engaged in public service. Thank you.

Mr. ARCHER. Thank you. Thank you for that commendation. We are very proud of the Archer fellows. And one of them is actually sitting in the back of the room behind the Members today.

Mr. DOGGETT. Great. Thank you.

The importance of today's hearing should not be understated. We have gone some 13 months without any hearing anywhere in America, to my knowledge, on the impact of the proposed Republican tax reform on individual taxpayers. And there is a great deal that needs to be explored about that.

We are about to leave in a few days until sometime after Labor Day, and in theory, we are about to have a tax reform bill that, as the Chairman indicates, could have far-reaching implications for individual taxpayers. I believe we need a thorough consideration of it with a wide range of opinion.

I am disappointed that the testimony of Seth Hanlon, from the Center for American Progress—like a witness that I offered last week—was rejected for this hearing. I think we need to be hearing more not less.

And, Ms. Stout, I think your testimony is a good example of that. Just the issue of retirement, you are the first person to testify this year before this Committee concerning retirement plans.

We know that there are millions of our neighbors across America who do not have adequate savings for their retirement. And looking at how our Tax Code impacts that and what changes we need to make I think is very important. You have offered valuable perspective, but we could devote one or more hearings just to exploring that question.

And, frankly, after looking at the Republican blueprint, I am not sure exactly what is being proposed on retirement, and I think that there are many people within the industry and the financial services industry that aren't sure either and have voiced some concern about the changes that may be contemplated by the very vague language of that provision.

I will tell you, the reason to look at retirement plans is also—it is a significant reason because of what we learn about the way these systems are working today. Sixty percent of American households get 16 percent of the tax benefits today on retirement plans. And the 20 percent top income earners get 66 percent of the retirement tax incentive benefits. So we have a system in which many working families are not adequately prepared for retirement. They have only a Social Security check and modest savings and maybe some ownership interest, some equity in their home.

And we need to look at retirement savings in terms of how we will reach out and support more, how we can, as you said, involve more small businesses in being able to offer plans for their owners and their employees. And how this measure affects those individuals is very important.

Mr. Rodriguez, I would ask you to comment about some of the challenges working families have in saving for retirement and to comment on what the impact on working families would be if we adopt another huge Bush-type tax cut that is not paid for.

Mr. RODRIGUEZ. Thank you, Congressman, for the question.

You know, it is a big problem certainly with low-income populations where retirement savings, opportunities at work just aren't there. And as you said, it is absolutely right: The Tax Code incentivizes the most retirement savings for those already doing it. And I think we have to find more ways to incentivize those at the lower end, those who are becoming more mobile, to be able to save for retirement.

So moving around the incentives, as you were saying, is going to be an important fix. It is part of the reason why we have such an enormous and growing wealth gap across the country, is because of the way that the Tax Code incentivizes savings primarily accruing at the top versus in other areas.

Now, we do have some great concerns about Rothification. I think we should proceed with some caution on that as we look at the entirety of the package, in part because those could be exploding tax expenditures in the outyears that really squeeze our budgets in ways that would make funding and revenue really inadequate for the things we care about.

Mr. DOGGETT. Thank you. Thank you, all.

Chairman ROSKAM. Mrs. Noem.

Mrs. NOEM. Thank you, Mr. Chairman. I appreciate you holding this hearing today.

Too often in the news we hear about multinational, international companies, and we know that all of these companies have tax departments that help them pay their taxes and figure out exactly what they owe.

But in reality, most of this complexity falls on hard-working taxpayers, people who struggle to pay their taxes correctly and try to navigate it around the kitchen table and get through the process and do it sometimes with the help of a CPA or a tax preparer but sometimes they don't have that advantage.

We would all agree that everyone needs to pay what is owed, but the current Tax Code robs people of their most precious commodity, and that is their time. And so I would like to focus on that a little bit today. Time could be better spent with their families, making their business more productive, investing in new opportunities, local community groups.

I talked to one CPA in South Dakota who told me this. He said: As a certified public accountant with 33 years of experience, I have watched the Tax Code become more complex, making it both costly and difficult to comply with. At the same time, the quality of customer service within the IRS has fallen. As a result, I see within my practice in clients a decrease in confidence in the tax system as a whole.

Tax reform gives us the opportunity to address these matters, to ease frustrations, and to restore faith and confidence in our tax systems.

So we need tax reform, not just for American businesses but, more importantly, for American families and individuals who are struggling with the burden that it places on them every day.

Chairman Archer, I would like to visit with you a little bit. I want to thank you, first of all, for being here and making it a priority and then all of your years of service as well. But I wanted to ask you what you have seen over the years in an erosion in American confidence in the tax system.

But then I want to focus in particular about your perspective on permanence in the Tax Code, because we have people propose to us constantly, and you have dealt with it over the years, of tax extenders or putting tax policy in place for a short period of time and what a disservice that does to a business or a family trying to plan for the future.

Could you speak a little bit with your background knowledge about the importance of having permanence in the Tax Code when we look at reforms?

Mr. ARCHER. Well, I am a strong believer in permanence, but I am not weighing everything in my life. I like things to be in a position and know that I can come back 5 years later and they will still be there. That is not life, unfortunately.

Mrs. NOEM. Yeah.

Mr. ARCHER. That is not the way things work. But there is no reason why the Tax Code cannot be one that is not forever changing because things are expiring. There are changes that will happen, and taxes will have to be changed at some point. We know that. That is a certainty in life, but not one where, every time you

put something in, you have to say, for revenue purposes, it is going to expire at a certain time, and, therefore, we are going to change the revenue effects.

Mrs. NOEM. You know, I think you make a valid point there. Because I have spent my life farming and ranching, and so we have seen in different policies, and when it has come to energy, short-term tax policies to maybe get an industry off the ground or something to get it started, knowing it is going to sunset when it gets its feet under it.

I think we do see that at a period of time. But also I know from starting a business from scratch, from running a hunting lodge that I started from nothing and running a family restaurant and running an insurance agency too, that if I am going to go to the bank and ask for a loan, they are going to want to know what my liabilities are going to be and what my business plan is. It is hard to do that unless you have a permanent Tax Code. So there is a role maybe for both in different parts of the Tax Code. Is that maybe the point that you are making, that there is a role in certain times—

Mr. ARCHER. Yes.

Mrs. NOEM. Okay.

Mr. ARCHER. Yes, absolutely. And in addition, it seems to me that taxes need to be as simple as possible. And I know that from doing my own tax return. I think your idea of trying to use a postcard for—I am not sure I would ever qualify to do that, but for the majority of Americans, if they could fill out on a postcard and send it in and say that is going to be it, that has a very attractive appeal. But whether you can do that, I don't know, because that means that you have to eliminate an awful lot of deductions.

What I worried about from the beginning of my Chairmanship of the Committee was having a Tax Code that tried to do everything itself for the American people. I think tax credits are not good.

And the idea that, "Well, we can make things happen in our society by giving a tax credit," I don't agree with that. And I think that complicates the Code and makes it difficult for the American people to understand it.

Mrs. NOEM. Thank you, Chairman.

I yield back, Mr. Chairman.

Chairman ROSKAM. Ms. Sánchez.

Ms. SANCHEZ. Thank you, Mr. Chairman.

And thank you to our witnesses for being here today.

I am a little bit disappointed that it took more than half a year before we finally had our first hearing on how tax reform would impact families and individuals, but I am glad that day has arrived and we are here.

It is impossible for me to address everything I feel should be a priority for individuals and families in just a few minutes, but I am going to just try to hit on a few key points before asking some questions.

I believe, and I have said this many times, that a lasting tax reform needs to be bipartisan, and it needs to be comprehensive. And I would strongly caution against a go-it-alone strategy that seems to have taken a hold of tax reform for the time being.

Lasting tax reform must be bipartisan. History is not on the side of going it alone. Tax reform also cannot be balanced on the backs of the middle class who already feel like they are being squeezed from all directions.

So far, the plans and tweets that I have seen from the House Republicans and the President would result in an astronomical tax cut to the tune of \$1.3 million per wealthy household.

The people that I represent in southern California, which the majority are hard-working middle class families and individuals, would receive roughly 70 cents per day under these plans. And I am sorry, but 70 cents a day is not going to help those families to better afford childcare, eldercare, plan for their retirement, or even take a small family vacation.

Mr. Rodriguez, I would like to turn to some points you raised in your testimony. As we know, the young, growing Latino population in this country is going to make up roughly a third of the U.S. workforce in the next decade. This is a population that has unique concerns within our Tax Code, but they also face the exact same barriers as other working families across the country.

Given the younger age of this population, many of them have not even entered the years when childcare and eldercare expenses are going to become some of the largest burdens and challenges that they face.

One of the principles that you highlighted in your written testimony was the need to support working families and children while also reducing poverty. Can you elaborate a bit more on the need for the Tax Code to address child and family care expenses in a meaningful way?

Mr. RODRIGUEZ. Sure. Thank you, Congresswoman.

It is exactly right. I think that the most effective antipoverty program we have right now is the earned income tax credit and the child tax credit, the refundable portion, and I know that is a bad word before some in the Committee, but it is enormously important. And 20 million families receive these credits, and it helps to lift 9 million families above the poverty level every year. These are working families raising children, and so finding ways, looking at the population that is young, hard-working, raising families, and providing and targeting better benefits or incentives and tax incentives to this group, who is beginning to either save for retirement or buying homes or doing the kinds of things that are living the American Dream, but need more opportunities to do so, and the Tax Code can do that.

So, if we can find more ways to do that, certainly some of the other elements—education is key. Childcare is also very, very key. There is a number of different ways that the Tax Code can assist these families directly.

Ms. SANCHEZ. Thank you.

With respect to the EITC—and I am glad that you mentioned it—that is a tax credit for middle and working class families. I feel like the rhetoric surrounding EITC paints it as just a handout, and can you explain why that is a wrong way to characterize the EITC?

Mr. RODRIGUEZ. Yes. Absolutely. These are all working families, working very hard, but just happen to be working for low wages and, even in accumulated households, don't reach the

threshold level to be able to pay Federal tax liability, but they pay payroll taxes. They pay into local and State taxes. They pay sales taxes in places. And they are burdened by these taxes. So the earned income credits are and the child refundable tax credit is an important way to assist these families.

Refunds go to, you know, buying a car. It helps you go to work or, you know, paying off bills or doing very, very important things that also generate economic activity in all of the communities across the country that many of the Members of the Committee represent.

Ms. SANCHEZ. And in the final seconds, can you please tell me what is the—what would be the outcome of our Tax Code and doing a tax reform that gives the majority of the tax cut benefit to the very wealthy? What will that mean to our country?

Mr. RODRIGUEZ. My biggest concern—thank you, Congresswoman. I mentioned that the wealth gap right now between Latinos and non-Latinos, white households is 10 to 1 on the dollar. My worry is that grows to 15 to 1, to 20 to 1 with increasing incentives for those at the very top of the wealth scale. When we eliminate inheritance taxes, when we look at the pass-through taxes, and we are just giving those tax breaks to a very small number of very wealthy households getting large tax cuts, my worry is that increases those disparities when we are having conversations about narrowing and improving equality across the board.

Ms. SANCHEZ. Thank you so much.

Chairman ROSKAM. Mr. Holding.

Mr. HOLDING. Thank you.

I want to thank the panel for all of your testimony today. I am particularly pleased to see Chairman Archer. The Chairman served with my predecessor on this Committee, Jim Martin. Of course, there was a 30-year gap between his service and my service on the Committee, but I am pleased to be—I am pleased to see Chairman Archer, and when I see former Governor Martin in North Carolina next month, I will give him your regards.

Mr. Chairman, thank you for having this hearing. Over the past number of hearings we have had, we have discussed in detail the importance of leveling the playing field and ensuring that businesses have a Tax Code that will allow them to compete here at home and around the globe, and I strongly believe that this fairness in the Tax Code is just as important to individuals, our citizens, as it is to our companies.

Some examples of unfairnesses in the Code to individuals, I will illuminate two. First is the alternative minimum tax, which was implemented 50 years ago, was put in place to address a small number of people who were paying no Federal income tax due to certain tax-preferred vehicles, but, today, it is clear this provision no longer addresses the original intent of the law. It instead creates an unnecessary and costly burden that outweighs the benefit of the provision.

Similarly, another provision, our current system of citizenship-based taxation, which was implemented during the Civil War as a means to discourage wealthy Americans from fleeing the country and, thus, depleting necessary wartime coffers, today, this burdensome regime of citizenship-based taxation has led to record high ex-

patriations and hampered the ability of our citizens to compete for jobs across the globe. Amazingly, it costs up to 40 percent more to hire American citizens abroad in many foreign jurisdictions, and so this section unfairly disadvantages our citizens and discourages American multinational countries from hiring Americans to run their international operations and also discourages foreign multinationals from hiring Americans to run their operations.

So, while moving to a territorial system for corporations is an integral part of our blueprint and a necessary part of tax reform, the competitive disadvantage will only become more apparent and grow if we fail to move to a residency-based taxation for individuals. So these are two examples that we have the opportunity to address on the individual level to have a fair tax reform plan for individuals as well as for corporations.

You know, another element that maybe I can get some comment on has to do with compliance. You know, the United States has a relatively high rate of voluntary compliance when it comes to individuals filing their tax returns, but as the tax system has gotten more complex, more and more individuals have to turn to professionals, tax preparers to help with their returns, so, you know, I believe that simplifying the Tax Code will preserve our tradition of voluntary compliance.

Chairman Archer do you have any comment on that, perhaps?

Mr. ARCHER. Well, needless to say, for one who continued to do his own tax return, simplification has a lot of appeal to me, and I think that it probably for most individuals may be one of the major concerns that people have, but, again, politically, it is not simple to get simplification. It is something that has been out there looming as an attraction for Members of this Committee for as long as I can remember, but in the end, we always seem to make it more complicated because the Tax Code has been used by so many people on the outside as a means of making whatever they want to occur happen in the country. And it has been used, in my opinion, far too much. And I feel that way about tax credits. The use of tax credits to me is not the purpose of the Code. The Code is primarily designed to raise the money to pay the government's bills and not to create all of these complexities.

Mr. HOLDING. Thank you. Thank you, Mr. Chairman.

Chairman ROSKAM. Mr. Thompson.

Mr. THOMPSON. Thank you, Mr. Chairman, and thanks for holding this hearing, and thank you to all the witnesses for being here.

Chairman Archer, thank you, and thanks for your previous service to this institution, and I, too, want to thank you for bringing up the issue of retroactivity. And this Committee has talked a number of times over the years as to repealing of LIFO and doing that retroactively would just be a monster for people who have used that tax provision to deal with. I appreciate you bringing that up.

And, Ms. Stout, I want to second Mr. Doggett's comments on your bringing up the issue of workplace savings and retirement accounts. If we did nothing else in this Congress but provided a means by which people could save while they are working for their

retirement years, it would mean so much for retirement security. That would be an excellent outcome.

When we are talking about tax reform, a couple of things that are really important to me: One is that whatever we do is paid for. I don't think we can afford to charge our kids and our grandkids with tax cuts that we give out today. And I think we have to insist on making sure that any reform that we do is, in fact, reform, not just an unpaid-for tax cut.

And we also have to focus—I agree with some of my other colleagues have mentioned this—focus on middle and working class individuals. This is a group of people in this country who really been left behind, and we need to figure out how we can incentivize their being able to get ahead and make more money.

And I think one area of doing that is to understand the importance of furthering education. Greater education—and all types of education, higher education, career training, low-tech training, whatever it might be—all of that is value added. The more that you have, the rule is the more that you make. And we need to figure out how to help people make more money and get better jobs and get the jobs that people want.

So I would really hope that we are able to focus on those types of things in our effort. It needs to be about the American people, and the American people who don't have lobbyists working for them on a day-to-day basis and the American people who haven't been able to take advantage of this Tax Code that the Chairman referenced is being used to help everybody under the sun but them.

Mr. RODRIGUEZ, I want to follow up on what Ms. Sánchez talked about because it ties in with my concern about paying for whatever it is we do in this tax reform. In the past, you know, we have been down this road before. We have seen this movie before. We do big tax cuts, and then we just pass the bill on to somebody else. We have a budget that has been referenced already today that is focused on cutting important aspects of our healthcare in order to pay for or to eventually pay for tax cuts or tax reform.

Can you tell me how cuts to Medicare or Medicaid will help working class people?

Mr. RODRIGUEZ. They don't. We have a more recent example, too, in the Kansas experiments of how this really doesn't work and puts enormous pressure on States to be able to provide adequate funding for services like education and workforce and programs that you mentioned that are enormously important to growth and economic mobility in those communities. Look no further than that to show you how this kind of approach to our budget and taxing system is wrong-headed.

Mr. THOMPSON. Kansas was so bad that they had to repeal what they had done.

Mr. RODRIGUEZ. Correct.

Mr. THOMPSON. And the Republican legislature recognized that to the point where they overrode the Republican Governor's veto of that repeal. It was devastating to people in that State.

Mr. RODRIGUEZ. Absolutely. And if you look at the current budget resolution proposal, you will look at the Trump budget as an example, you can see massive amounts of cuts to programs assumed, \$1.3 trillion in the nondefense discretionary programs. That

will put enormous pressure on these program areas. And you are right: In the healthcare bill, we saw \$500 billion or so in tax cuts, and of course, \$800 billion—

Mr. THOMPSON. I am running out of time, but if you would, I would like to hear from you or you can submit it in writing, I would like to see a list of tax reform that you think would help middle and working class individuals.

Mr. RODRIGUEZ. I would be happy to do that.

Mr. THOMPSON. Thank you.

I yield back. Thank you, Mr. Chairman.

Chairman ROSKAM. Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Chairman, for having this meeting.

And, Mr. Archer, thank you for being here and your service to our country.

The reason I love to be on this wonderful panel is because my colleagues always remind me why I became a Republican on my left. And they have heard this story before about my dad when I was 16 years old and took my first job at McDonald's, and my dad went through all the different taxes that got taken out of my check and said: Don't let the Tax Code change your behavior. You need to save money and you need to continue to work hard and make more money and get a good job.

And, today, when I was a Realtor—and, Mr. Rodriguez, you mentioned this and kind of got me thinking again, because I am looking at your bio, and it was a very good bio—but what was amazing to me, I never realized this until I started my own business, the first time in my life that I had to send a check to the IRS every quarter, which is very different than being a Congressman or working for a Congresswoman or a Congressman or working in a think tank, because you put it all on the line, and you are actually sending that check to the IRS.

Now, what is fascinating to me is today—you mentioned pass-throughs. Today, if you are a successful pass-through—and no one is going to guarantee that you are a successful business owner—in America, you are paying almost 45 percent of what you make at the top bracket just to the Federal Government. That doesn't include what you pay to the State in income taxes. That doesn't include what you pay your local government in income taxes. That doesn't include workers' comp. That doesn't include anything else that our three levels of government are requiring of you.

So I take issue with the fact that, as a pass-through, getting a tax cut is not appropriate. And I learned that from my immigrant father who has worked hard his entire life, retired now, who always complained about the taxes he paid with a sixth grade education as a steel worker, never making a lot of money. What great street smarts, Mr. Chairman.

Ms. Stout, your written testimony was fabulous when I read it. You wrote about simplification and consolidation, and you concluded that one does not necessarily equal the other, which I thought was really interesting. And you specifically mentioned the different kinds of employer savings plans, like 401(k) and 403(b) and 457 plans, and I have heard from a number of participants, including teachers and firefighters from my district, and in my district, in Columbus, Ohio, Nationwide Insurance is the largest pro-

vider of 457 plans in the country. So can you provide some more detail on the different populations that these plans serve and why it is important for us to, in considering tax reform, to make sure that we don't throw the baby out with the bath water and continue to allow for the incentivizing of these plans for people to save?

Ms. STOUT. Yes. Thank you, Congressman Tiberi. As far as the need—there is a need out there to have different types of plans, and we still have a need to keep them and simplify them. But as far as to answer your question directly as to the different employers that are served by the different plans, you know, it depends on what type of plan they want. You know, if it is a small employer, they might institute a simple 401(k) or a simple IRA versus, you know, the midsize companies might do a 401(k). The nonprofit world has 403(b) plans, and then, on the governmental side, the 457.

So, you know, there are different nuances to each of those plans that solve for the needs of those different industries and those different groups. I think that we still need to keep them, you know, work at simplifying things, but I don't think that, you know, one plan solves for everyone.

Mr. TIBERI. Mr. Rodriguez mentioned in his testimony that we should better target middle and lower income folks for incentives, and I agree with that, but I found in your testimony what was fascinating is that—and let me get this right—that the largest groups benefitting from 401(k) plans are employees who earn less than \$50,000 a year. In the last Administration, they worked to cap that amount of money that an employee could put in.

Ms. STOUT. Right.

Mr. TIBERI. Could that actually disincentivize employers from providing those plans and, thus, benefitting those workers that me and Mr. Rodriguez want to help?

Ms. STOUT. Right. Yes. Absolutely. It would have a huge impact if we took away the incentives of, you know, small businesses offering these plans. They need those incentives to get them to the table to even put the plan in place. And we have a coverage issue. So we don't want to put anything in the way of getting the small business owner to put that plan out there to help their workers.

Mr. TIBERI. Thank you.

Chairman ROSKAM. Ms. DelBene.

Ms. DELBENE. Thank you, Mr. Chair.

And thanks to all of you for being with us here today.

Mr. Rodriguez, I am coming here today from a Budget markup where we have been debating disastrous cuts to critical investments in education, in infrastructure, workforce training programs, and healthcare, and so I appreciate the reminder in your testimony that, when we talk about tax reform, we should remember that, first and foremost, we need to have the revenues to pay for these basic government functions that serve as the foundations for growing a strong and resilient middle class.

Yet, somehow, over the years, we have moved away from this simple concept and the Code has morphed into something of a monstrosity with layers of complexity that always seem to benefit the wealthiest few while everyone else is left to wonder how they keep getting left behind here in Washington.

Mr. Rodriguez, the Tax Policy Center has estimated that under the Republican blueprint the wealthiest taxpayers would see an average tax cut of over \$1 million, while middle class families would get around \$200, and the Trump plan offers middle class families a paltry one-tenth of 1 percent of the \$1.4 million cut the richest Americans could expect to see. So, at a time when my colleagues on the other side of the aisle seem bent on gutting funding for education, healthcare, and other critical resources for working families, do you think that even \$200 per family is anywhere near enough to make up for what Republicans want to take away in terms of healthcare or education resources?

Mr. RODRIGUEZ. No, not at all. And it is a huge issue. We, of course, do a lot of work in all of those areas between job training, education, and healthcare. And we know there are great needs and resource needs that are there. So we are enormously concerned about that.

Ms. DELBENE. Thank you.

Chairman Archer, thank you so much for being with us today. I imagine you know firsthand how elusive comprehensive tax reform can be, and I agree with many of the things that you said in your testimony that tax reform should not be corporate only, that it should be permanent to give people some ability to plan for the future, and that progress is achievable this Congress.

But there was one word that was conspicuously absent from your testimony, and that word was "bipartisanship." And I believe, without bipartisanship, that this Committee will never achieve any of the laudable goals that you outlined, and I wonder, do you agree with that?

Mr. ARCHER. I certainly believe that it is desirable to have bipartisanship, particularly on something that is as important as fundamental tax reform. It seems to me, as with healthcare reform, both parties should be a part of it. Otherwise, it seems to me that it is not going to be as long lasting as it should be.

Ms. DELBENE. And as you know, I am new to the Committee, but I have done some homework, and the 1986 tax reform process was far more extensive than what the Committee has done this year. The Tax Reform Act of 1986 was preceded by 30 days of full Committee hearings on tax reform, five hearings on the Select Revenue Measures Subcommittee, and three hearings in the Oversight Subcommittee, and a full 26 days of markup between September 18, 1985, and December 3, 1985.

And the Senate Finance Committee put in the hard work as well: 36 days of full Committee public hearings and 6 Subcommittee hearings, and 17 days of markup. And that is a far cry from what we are hearing now from Finance Chairman Hatch, who just yesterday said that the Finance Committee may not have a single hearing on tax reform this year.

So, Mr. Chairman, I would like to enter into the record the legislative history of the 1986 Tax Reform Act with your permission.

Chairman ROSKAM. Without objection, so ordered.

[The submission of The Honorable Suzan DelBene follows:]

[JOINT COMMITTEE PRINT]

John B

**GENERAL EXPLANATION
OF THE
TAX REFORM ACT OF 1986**

(H.R. 3838, 99TH CONGRESS;
PUBLIC LAW 99-514)

PREPARED BY THE STAFF
OF THE
JOINT COMMITTEE ON TAXATION



MAY 4, 1987

I. LEGISLATIVE BACKGROUND OF THE ACT

The following is an overall chronology of the legislative background in the 99th Congress of H.R. 3838, the Tax Reform Act of 1986 (Public Law 99-514).¹

A. Administration Tax Reform Proposal

In May 1985, President Reagan submitted the Administration's tax reform proposals to the Congress.² Previously, the Treasury Department, in response to the President's request in his 1984 State of the Union Address, had conducted a comprehensive study of the U.S. tax system and submitted the results of the study with recommendations to the President in November 1984.³

B. House Action

Ways and Means Committee

H.R. 3838 was introduced and ordered favorably reported by the House Committee on Ways and Means on December 3, 1985, after almost a year-long review of tax reform proposals by the full committee and subcommittees in public hearings and in markup consideration. The following is an overview of full committee and subcommittee activity on tax reform legislation during 1985.

Committee hearings

The Ways and Means Committee held 30 days of full committee public hearings on comprehensive tax reform proposals. The committee began public hearings on comprehensive tax reform proposals on February 27, 1985. Committee hearings on tax reform issues continued on March 26; May 30; June 4, 5, 7, 11-14, 17, 18, 20, 24-27; and July 8-12, 17, 19, 22, 25, 26, 29-31, 1985. Also, a committee hearing was held on May 16, 1985, on proposed technical corrections to the Deficit Reduction Act of 1984 (P.L. 98-369) and the Retirement Equity Act of 1984 (P.L. 98-397).

The committee's tax reform hearing consideration included 1984 Treasury Department recommendations, the President's tax reform proposal made in May 1985, as well as various Congressional and other proposals.

¹ In addition to this overall chronology of the Act, specific references to the legislative background of each provision are set forth in footnotes accompanying the explanation of the provisions in Part III of this document. These legislative background references include, as appropriate, citations to the following: H.R. 3838, as reported by the House Committee on Ways and Means on December 7, 1985 (H. Rep. 99-426); H.R. 3838, as reported by the Senate Committee on Finance on May 29, 1986 (S. Rep. 99-313); House and Senate floor amendments to H.R. 3838; and the conference report on H.R. 3838 as filed on September 18, 1986 (H. Rep. 99-841).

² The White House, *The President's Tax Reform Proposals to the Congress for Fairness, Growth, and Simplicity*, May 1985.

³ Treasury Department, *Tax Reform for Fairness, Simplicity, and Economic Growth*, November 1984.

Subcommittee hearings

Several Ways and Means Subcommittee hearings were held during 1985 that related to subject matters included in H.R. 3838.

Subcommittee on Select Revenue Measures.—The Select Revenue Measures Subcommittee held hearings on the following areas:

March 19, 1985 — Targeted jobs tax credit

April 1, 2, 16, 1985 — Acquisitions and mergers (with Oversight Subcommittee)

April 25, 1985 — Attorney's fees

May 22, 1985 — Carryover of net operating losses (NOLs)

June 6, 1985 — Tax burdens of low-income wage earners

Subcommittee on Oversight.—The Oversight Subcommittee held hearings on the following areas:

June 21, 1985 — IRS taxpayer refund delays

July 18, and September 5, 6, 1985 — Retirement income security (with Social Security Subcommittee)

September 20, 1985 — High-income taxpayers and partnership tax issues

Committee markup

The Ways and Means Committee conducted 26 days of markup on tax reform proposals: beginning on September 18, 1985; continuing on September 26, 30, October 1-4, 7-9, 11, 15, 23, 25-27, November 6, 15-17, 19-23; and concluding on December 3, 1985, when the tax reform bill, H.R. 3838, was introduced and ordered favorably reported (by a vote of 28-8). There was also a committee markup on technical corrections to the 1984 tax legislation on September 27, 1985, which was included as a separate title of the bill.

The committee report on H.R. 3838 was filed on December 7, 1985 (H. Rep. 99-426).

House Floor Action

On December 10, 1985, the House Rules Committee approved a modified closed rule on H.R. 3838 (H. Res. 336), making certain amendments in order for House floor consideration. This initial rule failed of passage (202-223, 1 "present") on December 11, 1985. On December 16, 1985, the Rules Committee approved another modified closed rule (H. Res. 343), which was adopted (258-168, 1 "present") by the House on December 17, 1985.

The House passed H.R. 3838, as amended, by voice vote, on December 17, 1985.

C. Senate Action

Finance Committee

H.R. 3838 was ordered favorably reported by the Senate Committee on Finance on May 6, 1986, with an amendment in the nature of a substitute. This action followed an almost year-long comprehensive review in the 99th Congress of tax reform proposals by the full committee and subcommittees in public hearings and markup

consideration. The following is an overview of full committee and subcommittee activity on tax reform legislation during 1985 and 1986.

Committee hearings

The Finance Committee held 36 days of full committee public hearings on comprehensive tax reform proposals in 1985 and 1986. In 1985, the committee held public hearings on comprehensive tax reform proposals on May 9, June 11-13, 17-20, and 25-27; July 9-11, 16-19, and 24-25; September 24 and 26; and October 1-4 and 9-10. In 1986, committee hearings were held on January 29-30; February 3-16; March 4; and April 21.

The committee's tax reform hearing consideration included the President's tax reform proposal made in May 1985, the House-passed bill, and various Congressional and other proposals.

Subcommittee hearings

Several Finance Subcommittee hearings were held during 1985 and 1986 that related to subject matters included in H.R. 3838, as amended by the Committee on Finance.

Subcommittee on Savings, Pensions, and Investment Policy.—The Savings, Pensions, and Investment Policy Subcommittee held hearings on the following areas:

September 9, 1985 — Post-retirement health benefits

November 22, 1985 — Targeted jobs tax credit extension

January 28, 1986 — Retirement Income Policy Act

Subcommittee on Energy and Agricultural Taxation.—The Energy and Agricultural Taxation Subcommittee held a hearing on the following area:

June 21, 1985 — Impact of taxation on energy policy

Subcommittee on Health.—The Health Subcommittee held a hearing on the following area:

September 9, 1985 — Asbestos-related disease trust fund

Subcommittee on Taxation and Debt Management.—The Taxation and Debt Management Subcommittee held a hearing on the following area:

January 31, 1986 — Mortgage-backed securities

Committee markup and reporting of bill

The Finance Committee conducted 17 days of markup on the tax reform bill: beginning on March 19, 1986; continuing on March 24-26, April 8-10, 14-18, 22, 24, 28, and May 5; and concluding on May 6, 1986, when the tax reform bill, H.R. 3838, as amended, was ordered favorably reported (by a vote of 20-0).

The committee report on H.R. 3838 was filed on May 29, 1986 (S. Rep. 99-313).

Senate Floor Action

H.R. 3838, as amended by the Finance Committee, was brought up on the Senate floor on June 4, 1986, and debate on the bill con-

tinued on June 9-13, 16-20, and 23-24, 1986, with passage of the bill, as amended, on June 24 (by vote of 97-3).

D. Conference Action

Conference

The Senate requested a conference on H.R. 3838 on July 15, 1986, and appointed the following conferees: Senators Packwood, Dole, Roth, Danforth, Chafee, Wallop, Long, Bentsen, Matsunaga, Moynihan, and Bradley. On July 16, the House agreed to the Senate request for a conference on the bill, and appointed the following conferees: Messrs. Rostenkowski, Pickle, Rangel, Stark, Gephardt, Russo, Pease, Duncan, Archer, Vander Jagt, and Crane.

Formal conference committee meetings were held on July 17-18 and 21, 1986, and concluded on August 16, 1986, when the conferees met and approved the conference agreement. The conference report on H.R. 3838 was filed on September 18, 1986 (H. Rep. 99-841, Vols. I and II).

House-Senate consideration of Conference Report

The House approved the conference report on H.R. 3838 on September 25, 1986, by a vote of 292-136, after a motion to recommit failed by a vote of 160-268. The conference report was considered by the Senate on September 26, 1986, and passed by a vote of 74-23 on September 27, 1986.

E. Enactment into Law

H.R. 3838, the Tax Reform Act of 1986, was signed into law by President Reagan on October 22, 1986 (P.L. 99-514).

F. House-Senate Consideration of H. Con. Res. 395

On September 25, 1986, immediately after its approval of the conference report on H.R. 3838, the House passed (by voice vote) H. Con. Res. 395, to instruct the enrolling clerk to make certain technical and clerical corrections in the conference report statute.

H. Con. Res. 395 was agreed to by the Senate (by voice vote) on October 16, 1986, with amendments. The House Rules Committee granted a rule on October 16, and the House adopted the rule (by voice vote) on October 17 for consideration of the resolution as amended by the Senate. Also on October 17, the House concurred in the Senate amendment with further amendments and returned the resolution to the Senate.

On October 18, 1986, the Senate agreed (by voice vote) to certain of the House amendments to the resolution, disagreed to certain other amendments, and insisted on certain of its amendments. Also on October 18, the House disagreed to the Senate amendments to the House amendments to the original Senate amendment. H. Con. Res. 395 was not agreed to by both the House and the Senate before the 99th Congress adjourned *sine die* on October 18, 1986.

G. Subsequent Related Tax Legislation

H.R. 5300, the Omnibus Budget Reconciliation Act of 1986 (P. L. 99-509, signed on October 21, 1986), contains a provision (sec. 8002)

increasing the Code section 6661(a) penalty on underpayments of tax to 25 percent rather than 20 percent as provided in H.R. 3838 (sec. 1504). The conference report on H.R. 5300 was filed on October 17, 1986 (H. Rep. 99-1012), and was passed by the Senate and the House also on October 17. Although H.R. 5300 was signed before H.R. 3838, the H.R. 5300 provision was intended to prevail since it was considered and passed by the House and the Senate subsequent to passage of H.R. 3838.⁴

In addition, H.R. 5300 includes a provision (sec. 8071) relating to a truck leasing transitional rule included in the Senate amendment to H.R. 3838 (sec. 204(a)), application of at-risk rule to low-income housing credit (sec. 8072 of H.R. 5300 and sec. 252(a) of H.R. 3838), and a transitional rule relating to treatment of certain rural housing under the passive loss rules (sec. 8073 of H.R. 5300 and sec. 502(d) of H.R. 3838).

⁴ See explanation in Title XV. Part. A., footnote 14. A technical correction may be needed so that the statute reflects this intent.

Ms. DELBENE. Thank you.

Chairman Archer, do you think that the Committee and Congress as a whole conducted a deliberative examination of revenue issues in the 1986 tax reform?

Mr. ARCHER. Well, clearly the 1986 tax reform took a lot of time to put together, and in the end, it prevailed with some very hard-hitting pressures from the top on both sides, I must say. I was very concerned, as I mentioned earlier today, with the fact that there was retroactivity in there that was going to undermine the value of real estate, and it was put in there, of course, to get extra revenue. And it disturbed me enough that I wanted to offer a motion to recommit with instructions. And I am convinced that I had the votes to beat the bill if I had been permitted to offer that motion to recommit with instructions.

Unfortunately, and I mentioned that there was a lot of pressure from the top, the ranking Republican in the House was called by the White House and told that he could not let me offer the motion to recommit with instructions and called me into his office and told me that he was going to have to personally take it away from me. There wasn't anything I could do. The power was there. It was unprecedented because the ranking Republican on the Committee was for the bill, so he had taken himself out of the process. I was the second ranking, and traditionally, I should have been given the motion to recommit.

So those things were going on behind the scenes. And in addition, of course, you not only had the President who signed on, but you had the Chairman of the Committee, who was then a Democrat, who was totally committed to it. And the pressure that he put on in the Committee was pretty incredible, too. So you had bipartisanship, but bipartisanship, in my view, did not produce a bill that was in the best interests of the country.

Ms. DELBENE. Thank you. My time is expired.

Mr. ARCHER. But that was my own prejudice, you understand. Chairman ROSKAM. Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman.

As I go around my district and talk about tax reform, the thing that I hold up at most of the meetings is this postcard. And believe it or not, this postcard is much more popular than the IRS Code as it exists. People are intrigued by it. I can't say that they read every single line of it and make calculations in their head on the spot, but the biggest question that I do get in my district about this postcard is, can I fill the postcard out if I file the alternative minimum tax? And I say there is not going to be—in our plan, there is not going to be an alternative minimum tax. So, for a great percentage of people in my district, probably the most frustrating part of the Tax Code is, in fact, the fact that they have to figure their taxes twice. They figure the first go round, and then, of course, they have to go through it again to see if they owe this other tax. What kind of effect, Mr. Archer, Mr. McKay, what kind of effect does that have on taxpayers when they physically usually cannot fill it out simply for that reason?

Mr. ARCHER. Congressman Marchant, I have always been in opposition to the alternative minimum tax. It made no sense. It was not good tax policy, and in the end, had it continued to be in place

without change, it would have generated more income tax revenue than the regular income tax, and to me, that did not make any sense.

So I think you are absolutely right. I hope you can do away with the alternative minimum tax, and if you do, you will do a service for the country.

Mr. MARCHANT. Mr. McKay.

Mr. MCKAY. Thank you, Congressman.

Complexity in the Tax Code comes in many forms. I mentioned before there is a half a dozen different definitions of the term “dependent.” There are more opportunities for simplifying the Tax Code than there would probably be room for in the eventual tax bill that comes out of Congress whether—whatever Congress decides about any particular provision like the alternative minimum tax or any other provision. Our point of view is we will, as an industry, both technology and professional practitioners, show up and serve to simplify people’s experience. The postcard is something that this industry is well prepared to deliver for the taxpayer. We mentioned before it ought to be electronic, but an electronic postcard can be a vastly simplified way of complying. There is a security issue in terms of a piece of paper that goes into a mailbox and so on, but it is actually a more interesting issue, and that is—I mentioned before the 1998 act that led the way to converting the country to electronic filing. And in the course of all that, IRS eliminated from its budget the overwhelming number of paper processing plants, the system of the old days of how paper returns were processed. But there was a huge advantage for the country in it. Putting a paper return into that system—and the IRS employees would key in key fields from the return—produced about a 20-percent error rate, whether the error was the original taxpayer or in the keying in of abstracts, about a 20-percent rate, the study said back then. Moving to an electronic filing system, that dropped to a 1- to 2-percent rate of error.

So there is real advantage in electronic implementation, but whatever the provisions of the Code are that you all decide as our policymakers, the ability to simplify that, whether it is an electronic postcard or any of the other tools that are available, including for simple returns, people can do it now on a phone with an app and take a picture of a W-2 and very quickly have a return brought in. So the private sector will bring the tools of innovation to this so that this will have the vision—realize the vision that you on the Committee and in the Congress choose as tax policy.

Mr. MARCHANT. Thank you, Mr. McKay.

Chairman ROSKAM. Mr. Larson.

Mr. LARSON. Thank you, Mr. Chairman, and thank you for holding this hearing.

And I want to thank all the witnesses and join in the accolades for Chairman Archer for his service here. And I would like to say from the outset, Mr. Chairman, that I never tire of listening to the story by Pat Tiberi of his immigrant parents. And because, actually, you know, on this Committee, there are so many stories to be told that make up the fabric of this Nation and what we are all about. And I would like to say that, in echoing Mr. Doggett’s comments, that we do need to have more hearings, and, frankly, we need more stories like Mr. Tiberi’s so that we can actually get to

the gut of what we need to do in terms of tax reform. And while we may have our disagreements and procedures, and that would allow me the opportunity to quote my Irish grandfather who would say, "Well, you know, trust everyone, but cut the cards," because oftentimes you may need a reshuffle and, in some cases, as Mr. Roosevelt said, a new deal and oftentimes it is the vagaries of society that leave government in a position where we have to do things.

Ms. Stout, I was specifically aligned with a lot of your comments because I do think we have to provide greater opportunities for people to save, and in doing so, I do support a number of the issues in and Mr. Tiberi talked about pass-throughs, et cetera. I think the way we have to look at this is, where can we assist and help people save?

We do have a prime sample of that. I ran an insurance agency. I know what it is like to meet a payroll. I was trained at an insurance school where we learned about investment and where we always said there were three legs on the stool, right? And one of those legs was Social Security. So, at the same time we are talking about enhancing benefits and the opportunity to save, shouldn't we be talking about something that hasn't been touched since Mr. Archer was the Chairman in terms of enhancing the opportunity for people to benefit from a system that has never missed a payment, but when is the last time there was actuarially an increase in the Social Security program? It was indexed back in 1983, and it hasn't been able to keep pace. It is an insurance program. It is not an entitlement. It is an insurance program. Have any of your premiums in insurance gone up since 1983? Yes, of course, they have, and everybody would acknowledge that.

So I think we have to, because what we saw what can happen, as my grandfather was alluding to in "trust everyone but cut the cards," all of the sudden, in 2008, your 401(k) became a 101(k). And without having that counterbalance, which is why we need more hearings like this, the counterbalance of knowing that there is a safety net, that there is a floor, which you also have to contribute to and save for and participate in, but that in the event of taking risk, that your government stands behind you. That was the lesson of the Great Depression, and I believe the lesson of 2008 as well.

What other plans would you recommend, Ms. Stout, that we could be using? And would you agree with that assessment about making sure that third leg on the stool is balanced as well as the others?

Ms. STOUT. Thank you, Congressman Larson.

I think absolutely both are important, Social Security as well as saving for yourself, whether—in an employer-sponsored plan. I think that, you know, working America is looking for ways to—whether it is incentives or education on how to save. So we have to make it simple for them.

I work with thousands—I have worked in my 20 years with thousands of working Americans, and, you know, they are struggling with, you know, figuring out their finances and how to put away some extra money. So I think both programs are important. You have to have that three-legged stool.

As far as other programs, I think a big focus should be on coverage and making it simple for employers to offer these plans.

Mr. LARSON. Mr. Rodriguez.

Mr. RODRIGUEZ. Absolutely. I think it is both a combination of greater access, also making it easier to save, but also improving the incentives for people to save as much as we possibly can for those target populations that are not saving but could do some more.

Mr. LARSON. Well, I want to thank Mr. Johnson, the Chairman of the Social Security Committee, who has agreed to have hearings on this, where we can put these plans out there. And I think that will only enhance both opportunities, governmentally and also from the private sector. We need both.

Chairman ROSKAM. Mr. Curbelo.

Mr. CURBELO. Thank you very much, Mr. Chairman.

And I thank the panel, and I especially want to thank Chairman Archer for his participation and for his service to our country. I also want to associate myself with some of my colleagues who have emphasized the importance that tax reform has for America's working families. There is obviously a great deal of frustration in this country. We see it play out in our politics. We see it play out on social media on an hourly basis. And I really think that tax reform is a solution, an instrument that can help address some of that economic insecurity that so many Americans feel. And I think we do have to put ourselves in the position of that family that maybe has two or three kids and has to pick them up from school, take them to school, take them to practice, and then, once a year, go through this difficult exercise of complying with the Federal Government and the IRS.

So I want to focus briefly on the complexity of the Tax Code. And, Mr. Chairman, the Tax Foundation estimates that, in 2016, Americans spent over 2.6 billion hours compiling tax returns, the cost of almost \$100 billion. Again, that is time and money which could have been used for productive economic activity or, better yet, time spent with family.

So, as we take on this task of comprehensive tax reform, Mr. McKay, I want to ask you the complexity of the tax system where a lot of Americans have to turn to professional tax preparers to file their returns. In recent years, preparer fraud is consistently listed among the IRS's dirty dozen of tax scams. I have been supportive of the Volunteer Income Tax Assistance Program, where those that make less than \$54,000 a year can file their returns with the help of an IRS certified volunteer. Can you talk about how increasing the standard deduction will reduce the dependence that so many Americans have on professional tax preparers?

Mr. MCKAY. Professional tax preparers provide a variety of functions. It is interesting. The National Taxpayer Advocate about a decade ago had a conference on tax reform, talked about exactly as you say, the one time a year when the average family takes stock of their financial situation, which is the moment of tax compliance. And she characterized it at the time as a national ritual that she felt that was actually some benefit from because, if people didn't take a hard look at their own finances then, most families would never look at them at all all year.

And so then the question really becomes the simplification of the experience, that it is less painful, less burdensome, less costly. The industry has worked very hard to create options, and it is an intensely competitive industry with a lot of innovation. Tax service comes in a lot of forms, everything from professional tax practitioners to accountants to tax attorneys to do-it-yourself software. There is a growing sense, I think, not only in the industry but from the taxpayers we serve, that they need practical commonsense simplification so that they can make financial decisions about what to do in the coming year for their family, rather than come away confused and struggling.

I would mention there is actually a couple of programs. The two largest ones, that are supported and sponsored by the government, are indeed the VITA centers all across this country. And there is somewhere in the area of about 2.5 million or a little more of returns prepared for free there every year. There is also the IRS Free File program, which is service donation by a large number of different companies through the IRS website under IRS regulation and consumer protection rules. That also creates about 2.5 million returns. Between the two programs, somewhere between 5 million and 6 million returns are generated for free: in one instance, in volunteer service centers within communities and neighbors; in the other, online, that you can access through your phone or through a computer. And between the two, you have significant help at no cost for lower and middle-income people. And it is a unique American invention. So many other countries, the government does the whole thing as a revenue-raising, revenue-collection process with no involvement of the citizens.

So the ideal situation would be to simplify to improve the taxpayers' understanding of their own taxation and enabling them to make better financial decisions for their future and, at the same time, take advantage of the capabilities of both tax professionals and tax technology innovations to make it simpler and easier for folks. That is why I said before, if you decide to have a postcard style tax return, that this industry will deliver that robustly so that it will be something that people have confidence in, and in all likelihood, having that electronic will also add security protections and easy access for people to use.

Mr. CURBELO. Thank you very much, Mr. McKay.

Chairman ROSKAM. Well, thank you.

I want to thank the panel. Mr. Archer, Mr. McKay, Ms. Stout, Mr. Rodriguez, thank you all for your time and your insight. I know I have benefited from comments that each one of you have had, and you bring in expertise and a wealth of experience to the Subcommittee, and we really, really appreciate it.

Let me try and just make some closing observations and comments if I could as a prerogative.

First, on process, Ms. Sánchez says that history is not on the side of going it alone, and I wholeheartedly agree with that. I am not trying to pile on, but my view is the ACA was an example of how not to do things. And so I think we are going to be better off if we try and create a bipartisan approach to this, and there is probably no argument there.

Another process point I think is important to make, and that is there is a temptation to evaluate tax reform discussions sort of in a very finite period of time, but I think the Committee should get credit for some of the hearings that took place on the Camp draft, similar themes that have come up, and there have been nearly 50 hearings in recent years on tax reform generally. And my assumption is now that you will see an increasing amount of activity the closer we get to a final product.

I think that there has also been some discussion about Kansas. It came up last week, and it came up this week as well. And I think there is a lesson for us on Kansas. And that is this: Don't allow a special provision, you know, to create essentially a trapdoor for pass-throughs, essentially. So there was a pass-through exemption that was allowed, and it didn't happen on the corporate side. And so what happened? You have a system that gets gamed, and ultimate activity doesn't result, come out of that. What we are proposing is not to do that, and we are proposing to lower the rates similarly for pass-throughs and corporations, C corps at the same level.

Speaking of States, I come from the State of what not to do. The State of Illinois has an underlying fiscal mess, a complete disaster. Rather than dealing with the underlying things that are driving it, my State legislature, over the Governor's objection, said: Hey, let's raise taxes.

And here is the net effect: People are leaving Illinois. They are going to Wisconsin. They are going to Indiana. They are going to all of the other attractive Midwestern States, like Ohio, because they have done a better job. And so that is an example, but that is a cautionary tale for us on what not to do.

The VITA centers that Mr. Curbelo mentioned I think provide real insight. I attended one—I visited a couple of them in my constituency most recently in west Chicago, Illinois, at a high school—or at a middle school there. Going in and talking to the volunteers, you gain real insight on this issue of complexity. So, if you are in a situation where you are visiting a VITA site, you are sitting down, and I was asking some of the volunteers: What is your average interview time for talking to someone?

And these are very modestly, you know, situated people, and they said: Oh, about 90 minutes.

Now imagine that. Going through the hassle of 90 minutes talking to some volunteer, backing and forthing, backing and forthing, and so forth, finally to come up with something and all this level of complexity that nobody up here interestingly is defending and nobody at the witness panel is defending, and yet that is what this very constituency is burdened with.

I think that there is also an interesting observation that I would like to make. If this yielded 70 cents a day, if that was the bottom line, if that was really the number, I wouldn't defend it. Seventy cents a day per family? I don't think that is really where the action is.

The Tax Foundation came up with a study, and I would ask unanimous consent to put this into the record.

[The submission of The Honorable Peter J. Roskam follows:]



The State-by-State Impact on Jobs and Family Incomes of the House GOP Blueprint

April 11, 2017

Scott A. Hodge

There have been a raft of studies recently isolating the effect of certain elements of the House GOP tax reform "Blueprint" on various industries and even the 50 states. While it is understandable that interest groups whose business models are tied to a particular provision of the tax code would wish to draw attention to how a specific element of the Blueprint would impact them, it is also important for lawmakers who are subject to a heavy dose of lobbying to recognize that the Blueprint is a comprehensive tax reform plan, so it is important to focus on the total effects of the plan on the economy and families.

Using the Tax Foundation's Taxes and Growth (TAG) macroeconomic tax model, our analysis found that the "plan would significantly reduce the cost of capital and reduce the marginal tax rate on labor. These changes in the incentives to work and invest would greatly increase the U.S. economy's size in the long run, boost wages, and result in more full-time equivalent jobs."

Indeed, the TAG model estimates that the plan would result in the creation of roughly 1.7 million new full-time equivalent jobs, while increasing the after-tax incomes of median households by 8.7 percent. The increase in family incomes is the result of both the income tax cuts and the broader rise in productivity and wages due to economic growth. These estimates take into account all aspects of the Blueprint, including the impact of the border adjustment.

The table below illustrates the state-by-state impact of the plan for both new jobs and the boost to after-tax incomes for middle-income families.

Impact of the House GOP "Blueprint" on Jobs and After-Tax Incomes by State

	Estimated FTE Jobs Added	Estimated Gain in After Tax Income for Median Households
United States	1,687,000	\$4,917
Alabama	23,062	\$3,872
Alaska	3,938	\$6,535
Arizona	31,424	\$4,546
Arkansas	14,355	\$3,723
California	191,767	\$5,536
Colorado	30,255	\$5,794

	Estimated FTE Jobs Added	Estimated Gain in After Tax Income for Median Households
Connecticut	19,696	\$6,341
Delaware	5,300	\$5,025
D.C.	9,154	\$6,096
Florida	97,220	\$4,248
Georgia	50,850	\$4,417
Hawaii	7,566	\$5,613
Idaho	8,069	\$4,491
Illinois	70,423	\$5,256
Indiana	36,036	\$4,523
Iowa	18,397	\$5,294
Kansas	16,546	\$4,773
Kentucky	22,386	\$3,688
Louisiana	23,201	\$3,995
Maine	7,236	\$4,416
Maryland	31,621	\$6,403
Massachusetts	41,563	\$5,904
Michigan	50,337	\$4,716
Minnesota	33,809	\$5,980
Mississippi	13,446	\$3,483
Missouri	33,131	\$5,150
Montana	5,462	\$4,471
Nebraska	11,852	\$5,261
Nevada	15,043	\$4,525
New Hampshire	7,811	\$6,584
New Jersey	47,548	\$5,947
New Mexico	9,749	\$3,925
New York	109,733	\$5,046
North Carolina	50,511	\$4,419
North Dakota	5,123	\$4,995
Ohio	64,194	\$4,637
Oklahoma	19,488	\$4,096
Oregon	21,351	\$5,293
Pennsylvania	68,777	\$5,254
Rhode Island	5,735	\$4,846
South Carolina	23,939	\$4,033
South Dakota	5,046	\$4,791
Tennessee	34,517	\$4,118
Texas	140,374	\$4,913

	Estimated FTE Jobs Added	Estimated Gain in After Tax Income for Median Households
Utah	16,539	\$5,764
Vermont	3,663	\$5,176
Virginia	45,763	\$5,349
Washington	37,586	\$5,850
West Virginia	8,803	\$3,726
Wisconsin	34,257	\$4,822
Wyoming	3,348	\$5,300

Note: The results here use Census figures to illustrate the income gains for median households by state. These estimates will differ slightly from our previous estimates using aggregate IRS figures to illustrate the income gains for taxpayers at various income levels.
Source: Tax Foundation TAG Model, U.S. Census

Chairman ROSKAM. The Tax Foundation has—their study shows that there is an increase in 1,687,000 jobs, full-time equivalence, and an estimated gain of, wait for it, \$4,917 in after-tax income for median households throughout the U.S. In my home State: \$5,256. In Ms. Sánchez' home State, who raised this question, even more than that: \$5,536. So that will be part of the record.

There is also an interesting thing as it relates to your testimony, Mr. Rodriguez, and I am not asking you to comment, but it is just an observation that I had, and it is this: A few years ago, I had a meeting with one of the presidents of one of the large Hispanic business organizations, and I think I remember the one it was. I don't want to say it out loud because, then, if I am wrong and so forth. But he came in and he said something to me, which is really interesting, and it made a big impact on me. He said: We are against the estate tax. We are against the death tax.

I said: Really? That is not what I would have expected you to be talking to me about.

And he said: Yeah, here's why. For the first time ever, Hispanic families are making serious money in this country—not all of them by any stretch of the imagination. But he said: Why is it that when Hispanic families are making money, there is an estate tax? Where was the estate tax 100 years ago when other families were making all their money?

And I just leave it there. It is a very provocative question, particularly coming from somebody who has a business organization.

In order for us to get to this bipartisan approach, we have to settle out an underlying tension. And it is a tension that surfaces occasionally, and you heard a little bit of it today. And the question is, do we view the economy as a zero-sum game? Do we view that pie as expanding, where people benefit, or do we view it as something that, if someone benefits, then that comes at someone else's expense? There was a subtext throughout a lot of the discussion, a lot of the questions and so forth.

I personally reject the notion that it is a zero-sum game. And Mr. Tiberi, in his observation, was talking about, you know, the tax burden that is out there. We are not going to settle that today, but it is a question that really has to be wrestled with, and we have to come to essentially a worldview about it because if all this is, is a matter of redistribution, then that is one thing. But I think everybody is here saying: No, no, no, no, that is not what we want alone; we want to make sure that there is growth here. And growth comes if we do this the right way.

I think we need to explore a great deal more, Ms. Stout, about what you were talking about, credits on encouraging auto enrollment for example. That would be something very, very interesting. And I think, to get back to one of Mr. Rodriguez' key points, this notion of savers getting tapped out at such a low level with very low headroom and very little capacity for them to save, that is something that I think we can vastly improve.

And, look, when push comes to shove, this postcard is so attractive and so enticing, and I go back to this theme in many other discussions. Think about the premium that we put on simplicity in other elements of our lives. Just think about that for a second. We

want to go through TSA PreCheck. We want to go through the E-ZPass lanes on the toll ways. We want to go through the 15 Items or Less lane, you know, at the grocery store. We want an expedited process. I mentioned this, my expectation of the airlines app and so forth. We expect this in all aspects of our lives, and yet the one thing that has an impact on every single bit of the economy, the Internal Revenue Code, is cumbersome to the point of absurdity.

So I think what we have settled here today is nobody likes where we are. Everybody wants to move somewhere else, and what we have to do is sort out among us how it is that we do that.

But on behalf of our entire Committee, I want to thank each one of you for your willingness to spend time with us this afternoon, and I thank my colleagues, particularly these two brothers, for sticking it out until the end. The Committee is adjourned.

[Whereupon, at 4:23 p.m., the Subcommittee was adjourned.]

[Questions for the Record follow:]

HEARING ON HOW TAX REFORM WILL SIMPLIFY OUR BROKEN TAX CODE AND HELP INDIVIDUALS AND FAMILIES

Questions for the Record

Question from Rep. Tiberi

Question for Mr. McKay

Question:

Mr. McKay, the Stolen Tax Refund Fraud Information Sharing Analysis Center (ISAC) is very encouraging. As we have learned from ISACs in other industries, having robust information sharing is critically important to detecting and preventing cyber criminals. What barriers do you see to making the ISAC fully functional?

Answer:

The ISAC has been launched and began functioning this past January, providing valuable insights and analysis. It will be important for the Tax ISAC to become increasingly robust in its capabilities over time, as a central part of the nation's strategy to defend the tax system against identity theft refund fraud.

Unfortunately, we are learning over time that there are regulatory barriers preventing some States and even the IRS itself from sharing certain types of data with the ISAC, even on an anonymized and secure basis. Lessons learned from ISACs in other sectors of the economy show that the more robust the information sharing from all participants, the more valuable the insights and contributions of the ISAC in combatting cyber-attacks.

The Tax ISAC has members from across the tax ecosystem including the IRS, State Departments of Revenue, tax preparation industry and financial institutions. Ensuring robust information sharing into the ISAC, and gaining access to essential resulting intelligence information for ISAC participants across the tax ecosystem, is critically important to success. This point has been highlighted in the most recent report from the Electronic Tax Administration Advisory Committee (ETAAC), and we encourage Congress to adopt and implement the ETAAC recommendations to removal of barriers for information sharing. Furthermore, the ISAC does come at a modest monetary cost to operate, and funding to accomplish that will be important over the years ahead. However, that cost is far outweighed by the benefits the ISAC can provide for both the Federal and State tax systems. This point is also highlighted in the most recent ETAAC report. Efforts to secure funding, removing barriers to information sharing, and ensuring the future continuity of the ISAC, are all critically important to its success.

Questions from Rep. Roskam

Questions for Mr. McKay

Question 1:

Thank you for highlighting the public-private partnerships that are aimed at helping taxpayers with their compliance burdens. I have long been supportive of making the Free File program

permanent. As we talk about simplifying the tax code today, could you also highlight some ways in which we could simplify the Free File program?

Answer:

Any reform of the tax code would automatically simplify the Free File Program, because it would help to eliminate unnecessary complexity in the underlying tax code itself, but thus simplify compliance for millions of lower income working families who take advantage of the Free File Program.

Industry was pleased that IRS included Free File for the first time on its latest IRS-To-Go electronic mobile app this past tax season, but we encourage IRS to increase their public education and awareness efforts about the availability of the Free File Program. Extending the life of the Program to provide taxpayers with assurance in the stability and availability of the Free File Program long-term would be very beneficial to the taxpayers who depend on the Program each year to help them comply with their tax obligations. Free File should really be viewed as the electronic online counterpart to the VITA in-person tax service program. Together they deliver between 5 and 6 million free returns to American taxpayers every year. In addition, currently 23 States have chosen to adopt their own Free File Program at the State level, based on the IRS Free File Program and the Treasury Department's Negotiated Public Rulemaking that created Free File fifteen years ago. Free File enables these States to provide free tax services to their citizens at no public expense. And so, long-term stability for the continuation of IRS Free File would also directly assure ongoing stability for the companion State Free File Programs as well, and avoid the unfunded mandate States would experience if that had to replace Free File with publicly-funded 'free' services at the State level due to expiration of the Free File Program at the Federal level. As a public service, cost-savings public-private partnership, Free File needs to be viewed holistically for its national impact and benefit for taxpayers.

After 15 years of service, and more than 50 million Federal free returns, the Free File Program has collectively saved the Federal Government and participating State Governments billions of dollars in cost avoidance by not diverting scarce resources to create duplicative tax services at public expense. And over the 15 years of this free program, taxpaying consumers have saved an estimated \$1.5 B in personal tax compliance costs through their use of the federal Free File alone. In fact, a broader participation of States over time would help to provide free tax preparation software solutions to more taxpayers, and save more revenue dollars to be able to optimally perform those functions that only Government can do as tax administrator. Growing the Free File Program would also eliminate taxpayer confusion between different treatment of Federal and State tax returns, and thus simplify the tax compliance experience, and reduce its burden and cost, for millions more taxpayers nationwide.

Question 2:

Relating to the electronic postcard in your testimony, could you elaborate more on how an e-postcard would work for taxpayers? How could the industry partner with the IRS to facilitate this?

Answer:

Industry is ready and able to rapidly develop the innovations necessary to deliver an Electronic Postcard tax return at no cost to the public purse. The Congress and President first need to determine what changes it will make to the Tax Code for individual taxpayers; the industry can then innovate a user interface that will reflect the look and feel of an e-Postcard, which will then be populated through a plain-English interview to gather the information that will complete the return, and which will then be summarized on the e-Postcard; necessary financial information can often be populated automatically into the return at the taxpayer's direction; once the taxpayer has reviewed the final e-Postcard return it will then be electronically filed at their direction. IRS will then automatically and electronically receive the e-Postcard return for processing.

In the same way, the tools of modern technology can deliver an e-Postcard experience for taxpayers who utilize professional tax practitioners to assist them in fulfilling their compliance obligation. The tax compliance experience can be simple, and will deliver on the vision of a simplified return as Congress has contemplated.

An Electronic Postcard will be important as the delivery methodology for many reasons, but one of paramount importance is security. The IRS Security Summit – where industry and government are closely partnered – has instituted measures to ensure that the use of data analytics can detect and ultimately prevent stolen identity refund fraud. This work is directly linked to the use of technology in filing returns electronically. Once Congress has enacted Tax Reform legislation, IRS will work with Industry to establish the necessary new or revised forms, tables, other changes and filing requirements, and then each party – the IRS and Industry – will move quickly to execute their end of implementation in the tax system, and deliver it in time for the start of tax season. But this is also why we strongly urge Congress to begin with the end in mind, and seek to conclude the legislative tax reform process in sufficient time to allow Government and Industry to fully and robustly implement the changes you adopted in time for the start of Tax Season.

And as to any question regarding paper filing vs. electronic filing, the Congress established the national policy objective of converting the nation to electronic return filing back in the 1998 IRS Restructure and Reform Act. That mission has long since been accomplished. And today the IRS, and many State departments of revenue, have closed down much of their paper processing operations and facilities, replacing them with electronic return acceptance and processing, savings hundreds of millions of dollars in tax administration costs. Reverting taxpayers back to paper returns would not only involve a return to the methods of the last century, but would more importantly challenge Government's ability to process them. This would lead to having to re-invest in rebuilding the paper processing facilities which comes at a large monetary cost, and would backlog the system with paper returns that would sharply slow refund processing for taxpayers.

Public-Private Partnership collaborations in the past have included conversion to a national system of electronic filing, delivering the Free File Program, and Industry partnering with both Federal and State Governments to protect the tax system through the IRS Security Summit. Congress can be confident that the privately funded inventions and innovations of Industry to deliver tax compliance products and services to taxpayers will continue robustly, and

the tax reforms enacted by Congress will be fully delivered to the American family to empower them in managing their tax and financial affairs. At the same time, IRS would continue to serve in its essential role as the administrator of the tax code, including not only revenue collection and compliance enforcement, but in driving identity theft refund fraud out of the tax system through its Security Summit and ISAC partnerships with State Governments and the Private Sector. This division of labors is the most efficient and effective manner to continue essential citizen engagement and support and enable the Voluntary Tax compliance system we have in the United States.

Question 3:

The Electronic Tax Advisory Committee recently released its annual report to Congress, which provides a recommendation that the IRS should implement the necessary mechanisms for taxpayers to electronically file an amended return. Would this be through the IRS Future State that you testified about? What would be the division of labor that you referenced in your testimony for this? What role would the government play and what role would industry play?

Answer:

CERCA endorsed the recommendation of the Electronic Tax Administration Advisory Committee (ETAAC) that IRS should implement the changes necessary to enable its acceptance of electronically filed Amended Returns on Form 1040X, through further modernizing of the existing IRS Modernized E-File (MeF) System to accept such electronic filings for the first time. Industry will, and already does, provide the independent, easy means of tax compliance and return preparation for taxpayers needing to prepare an Amended Return, through both electronic tools and professional tax services.

Taking the overdue step of enabling the acceptance of e-filed Amended Returns should not additionally lead to the expenditure of scarce taxpayer dollars for Government to develop and provide its own publicly-funded technology resources to duplicate private sector return preparation for IRS to perform directly with taxpayers. Simply enabling the electronic filing acceptance of the 4 million annually amended tax returns already being prepared and submitted on IRS Form 1040X would be the most cost effective and efficient step for enhancement of the tax ecosystem.

Enabling acceptance of electronically filed tax return amendments through MeF would avoid the need for taxpayers, tax professionals and the IRS to continue to rely on paper to amend previously filed tax returns, and would actually save the Government money by reducing unnecessary operating costs for processing paper Amendments. It also comports with State tax administration, where many States have already moved forward in developing a method for accepting electronically filed amended returns. If the IRS implemented this capability in its MeF system, there would be a consistent transmission channel for both Federal and State amended returns. This will provide a more seamless experience for taxpayers and reduce tax administration burdens on both the IRS and State revenue agencies.

Industry already provides taxpayers the Voluntary Compliance tools and services for amending returns; the IRS acceptance of these amended returns via e-filing through the IRS MEF system is the missing element. We join with ETAAC in recommending that rather than invest scarce public resources on developing, deploying and operating duplicative tax return preparation technologies in the IRS Future State vision, those resources would be better focused

on doing those things that only Government can do in its unique role as the nation's tax administrator, revenue collector and compliance enforcer.

In this specific case that division of labors would mean Government should close the identified gap in today's 1040x filing process by updating the IRS Modernized E-File System (MeF) to enable the acceptance of electronically filled Amended Returns. In the Free File Program, multiple participating software companies already include the availability of free 1040x returns for their Free File Users. The Tax ecosystem will continue to assist taxpayers in preparing and delivering those returns to the IRS.

A copy of CERCA's full letter to the IRS on these recommendations is attached.

[Submissions for the Record follow:]



July 19, 2017

Dear Chairman Roskam,

I write today on behalf of more than 3.2 million activists in all 50 states to urge your committee to follow through on the promise that has been made to deliver a fair, simple tax code that American individuals and families can trust and understand—one that works for ordinary Americans, not special interests.

Our current tax code is too complex, convoluted and confusing. According to the [National Taxpayer Advocate's](#) 2016 report to Congress, the U.S. tax code is 4 million words long. It takes taxpayers 6 billion hours and \$195 billion to comply with the requirements of the code each year. And of the more than 100 million taxpayer phone calls to the IRS last year, only one quarter were answered by an actual person. It's no surprise, then, that [73 percent](#) of Americans want to see tax reform happen this year.

We have been encouraged to see a number of good proposals on the table from both Congress and the White House that will help to ease the burden of tax compliance and allow everyday Americans to keep more of their hard-earned income. These include: reducing the number of tax brackets, eliminating most special interest loopholes and carve outs, lowering rates across the board, reducing and simplifying taxes on investment, and the elimination of harmful provisions like the AMT and death tax.

Enacting these proposed reforms would benefit American taxpayers directly—by leaving them with more time and money to spend on things that matter most to them—and indirectly—by reigniting economic growth in this country, leading to job creation and higher wages after years of stagnation.

All of these potential benefits would be undermined by imposing any new burden on American taxpayers and consumers. Proposals such as the Border Adjustment Tax, a VAT, a carbon tax or any other new tax would only shift the burden of tax reform around, rather than actually focusing on lowering rates and growing the economy. I strongly urge this committee to remove harmful provisions like the BAT from further consideration in tax reform, and to focus on positive, pro-growth provisions like the ones highlighted above.

Our network of activists is fully committed to helping deliver the best possible reform package for American taxpayers this year, relieving the burden of our current code by lowering rates and simplifying the filing process. We urge this committee to seriously consider our recommendations and to follow through on the promise to deliver comprehensive reform this year.

Sincerely,

Brent Gardner
Chief Government Affairs Officer
Americans for Prosperity

Americans for Prosperity (AFP) exists to recruit, educate, and mobilize citizens in support of the policies and goals of a free society at the local, state, and federal level, helping every American live their dream – especially the least fortunate. AFP has more than 3.2 million activists across the nation, a local infrastructure that includes 36 state chapters, and has received financial support from more than 100,000 Americans in all 50 states. For more information, visit www.AmericansForProsperity.org.

###



THE AMERICAN INSTITUTE OF ARCHITECTS

STATEMENT FOR THE RECORD

The Honorable Peter Roskam, Chairman
The Honorable Lloyd Doggett, Ranking Member
U.S. House Committee on Ways and Means Subcommittee on Tax Policy

August 1, 2017

Introduction

Thank you for holding a hearing on July 19, 2017 entitled *How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families*. The American Institute of Architects ("AIA"), the leading professional membership association for architects since 1857, strongly supports comprehensive tax reform that lowers marginal tax rates for individuals, pass-through entities, and corporations, while broadening the tax base and simplifying the tax code.

We recognize that tax reform is a balancing act. Lowering tax rates will require curtailing or discarding many tax expenditures, while maintaining and improving a limited number of tax policies that support important policy objectives. But we see tax reform as an opportunity to provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

As such, we applaud you for your attention to this important matter. We are grateful for the opportunity to submit the following comments and to work with you to advance

meaningful and lasting tax reform legislation.

Our strong hope is that tax reform results in simple, commonsense tax policies for businesses of all sizes, aimed to spur innovative, economically vibrant, sustainable, and resilient buildings and communities. As you pursue reform, we urge consideration of the following principles:

- Preserve tax policies that support and strengthen small businesses, which account for the vast majority of U.S. architecture firms;
- Advance tax policies that support economically vibrant, innovative, sustainable, and resilient buildings and communities; and
- Ensure fairness in the tax code.

This memorandum provides an overview of several policy initiatives to advance these principles that are of interest to the architecture profession. We appreciate your consideration of these initiatives as you move forward with the legislative process.

The American Institute of Architects
1735 New York Avenue, NW
Washington, DC 20006
www.aia.org

The American Institute of Architects

AIA represents more than 90,000 architects, emerging professionals and allied partners nationwide and around the world.

In 2015 alone, the 18,262 architecture firms owned by AIA members grossed billings of over \$40 billion, driving economic activity and job growth in communities across America. Moreover, most architecture firms at which AIA members work are small businesses, with nearly 95 percent of firms having fewer than 50 employees.

Architects work to advance the public's quality of life through their commitment to healthy, safe, resilient and sustainable communities. From designing the next generation of energy-saving buildings to making our communities healthier and more vibrant and from helping neighborhoods rebuild after disasters, to exporting American design know-how to the rest of the world, architects turn dreams and aspirations into reality.

Strengthen Small Business

In the architectural profession, as in the broader economy, small businesses are an engine of economic growth and opportunity. As noted above, the overwhelming majority of U.S. architecture firms are small businesses with fewer than 50 employees. A significant portion of these firms are organized as pass-through entities, including partnerships and S corporations. Support for these small businesses should be a critical part of any tax reform effort.

Comprehensive, Not Piecemeal Reform

Tax reform can help small businesses expand their operations and drive job creation – but only if Congress takes a comprehensive approach to addressing tax issues for individuals, pass-through entities, and corporations. “Corporate-only” tax reform would leave pass-through entities at a severe disadvantage, harming architecture firms and other small businesses.

Reduced Tax Burdens for Pass-through Businesses

Architecture firms organized as pass-through businesses can face combined tax rates of 45 percent or more when federal, state and local taxes are accounted for – which amounts to one of the highest effective tax rates in the world. As such, we strongly support reductions in marginal tax rates for all business entities. Allowing businesses to keep more of their hard-earned money will encourage them to reinvest and hire more workers.

In addition, we appreciate your continued efforts to achieve greater parity between the corporate and pass-through tax systems through your work on “corporate integration.” Rate parity is a key priority for the AIA, as it would eliminate distortions favoring certain forms of business entity over others. The tax code should not pick “winners” and “losers” in this way.

At the same time, we urge caution in establishing any requirement for sole proprietorships and pass-through businesses to pay or be treated as having paid “reasonable compensation” to their owners. We are concerned that such a requirement could inappropriately recategorize legitimate business income as compensation, leading to an effective tax increase on pass-through businesses. While the AIA recognizes the need to distinguish business income from compensation, this distinction must be drawn carefully to avoid penalizing the pass-through community.

Driving Investment in Energy Efficient Buildings

We are aware that several members of the Senate Finance Committee, as well as members of the House Ways and Means Committee, have an interest in expanded expensing of capital investment. Their interest reflects the strong link between cost recovery and economic growth. In the simplest terms, expensing puts more money back in the hands of business owners faster

– encouraging investment in new products and services.

Architects are familiar with the powerful positive effects of accelerated cost recovery through our experience with the Section 179D deduction for energy efficient commercial buildings. By allowing business owners to immediately expense the cost of energy efficient improvements, Section 179D has encouraged billions of dollars in capital investment and has supported hundreds of thousands of jobs in the construction, engineering, design, and manufacturing industries since it was added to the tax code in 2005.

These benefits are confirmed by a recent economic impact study conducted by Regional Economic Models, Inc. ("REM"), the executive summary of which is attached to this statement as an appendix. REM's conclusion is unequivocal, finding that "Section 179D is an engine of economic and employment growth." In particular, an enhanced tax incentive for energy efficient commercial buildings could support up to 76,529 jobs and contribute almost \$7.4 billion toward our national GDP each year. These results represent a significant return on the taxpayer investment in Section 179D, well in excess of the provision's revenue cost.

Given this favorable analysis, we strongly believe that it is remains important to offer tax incentives for energy efficient design. The benefits of greater energy efficiency – cost savings, energy independence, and reduced carbon emissions, to name a few – are significant and demonstrate the impressive "return" on taxpayer investment in provisions like Section 179D.

Drive Taxpayer Savings through Energy Efficient Public Buildings

Section 179D's unique allocation provision has allowed tax-exempt public entities to allocate the deduction to the designer of a building or efficiency project. This feature enables architects and engineers, among

others, to offer cost-effective design services for the development of energy efficient buildings by school districts, state governments, and other public sector entities. Allocation can help defray some of the upfront costs associated with energy efficient improvements, leading to significantly lower energy bills over the school's lifetime and, ultimately, more money in taxpayers' pockets.

The AIA encourages you and the Committee to ensure that the benefit of the allocation provision is retained as part of tax reform, notwithstanding any potential elimination of specific cost recovery provisions (such as Section 179D) in favor of expanded expensing more generally. Without the ability for tax-exempt entities to share the tax attributes associated with investments in energy efficient improvements with taxpayers that are able to use them, public entities will lose a crucial source of support for cost-effective energy efficient design. We would be pleased to share our ideas about possible ways to implement this important policy objective.

Improving International Competitiveness

American architects are leading the profession and industry around the world. Overseas demand for American architects is immense and growing as architecture firms engage with developing markets abroad. In this context, we strongly support proposals to enhance the international competitiveness of the U.S. tax code. For too long, our country's disproportionately high tax rates and complex "worldwide" method of taxation have curbed the potential for American businesses operating overseas. Eliminating these policies will make it easier for architecture firms and other American companies to compete abroad, driving growth here at home.

In addition, we note the House blueprint's discussion of the proposed elimination of the Section 199 deduction for domestic production activities. Section 199 includes spe-

cific provisions aimed to support domestic architectural services which have been instrumental in bolstering the competitiveness of American architects on the global stage. While we understand that reducing tax rates and shifting to full expensing may replicate some of the effects of the Section 199 deduction, we urge careful attention and analysis to ensure that the architecture firms and other American businesses that have benefited from this provision are not left “worse off” by its elimination in tax reform. American businesses continue to face extreme competitive pressures in the global marketplace, and the tax system should not impose any competitive disadvantages on U.S. firms.

Supporting a Vibrant Built Environment

The tax code can be a powerful tool to support innovative, economically vibrant, sustainable, and resilient buildings and communities. To that end, we encourage you and the Committee to continue and improve tax policies aimed at historic preservation and innovation.

Preserve Incentives for Historic Preservation

Among the most important incentives supporting revitalization of communities throughout the country is the Section 47 Historic Rehabilitation Tax Credit (“HTC”). Weakening or eliminating this credit would endanger the economic feasibility of nearly all historic rehabilitation projects. Without the HTC, the numbers simply do not work. The rehabilitation of historic building suffers from a financing gap because rehabilitation is more expensive than new construction. Also, 84 percent of all HTC transactions are located in low-income census tracts. Without tax incentive support, these properties could sit vacant for decades, exerting a blighting influence on the surrounding neighborhood.

Research conducted for the National Park Service by the Rutgers Center for Urban Policy Research documents that since en-

actment of the HTC in 1981, the credit has leveraged \$117 billion in private investment in historic rehabilitation, created nearly 2.5 million jobs and supported the rehabilitation of more than 40,000 historic buildings. The HTC is the most significant federal investment in historic preservation. It has also proven to be an efficient use of taxpayer dollars. Over the credit’s 34 year history, the federal government has allocated just over \$24 billion in tax credits, but collected \$28.6 billion in federal tax revenue from rehabilitation projects – more than paying for the program. For every dollar of public expenditure, private investors contribute four dollars toward the rehabilitation of historic properties.

Rehabilitation projects across the country are putting Americans back to work. In a typical project, 60-70 percent of the total cost is labor as compared to new construction where labor often accounts for less than 50 percent of the total cost. Laborers on a rehabilitation project are more likely to be hired locally, so their earnings support the local economy. In fact, 75 percent of the total economic impact of a historic rehabilitation project accrues to the state and city where the property is located. Moreover, projects are ideally suited to completion by emerging small businesses.

Given the HTC’s proven track record of driving economic and employment growth across the country, we strongly urge you and the Committee to retain this important incentive in tax reform.

Enhance Incentives for Innovation

Architecture is not merely an exercise in aesthetics. As buildings become more complex and clients demand more from their designs, architects must innovate to develop new ways to redefine what is possible. This often requires complex modeling and advanced computational analysis to assess everything from soil composition to wind resistance, supported by bespoke software and other tools. The Section 41

credit for research and development activities ("R&D Credit") provides a critical incentive for firms to pursue these innovations.

However, while a number of activities associated with architectural design qualify for the R&D Credit, over the years AIA members have reported a variety of complications in claiming the incentive, leading to costly and time-consuming audits. Improving the R&D Credit's administrability for design-related innovations should be an area of focus in tax reform. Making it easier for design firms to claim the credit will help drive new advances in design, and enhance architects' efforts to transform the built environment.

Preserve the Cash Method of Accounting

Architecture firms and other professional service companies rely on the cash method of accounting to track their income and expenses. The cash method is rooted in a simple principle: businesses – particularly small businesses that may lack sophisticated bookkeeping capabilities – should pay taxes on income when payment is received.

Unfortunately, some have proposed repealing or limiting the availability of the cash method, requiring businesses to shift to the more complex accrual method. Under the accrual method, firms pay taxes when the right to receive income is fixed – not when they actually receive payment. As a result, requiring these firms to use the accrual method would subject those who own and operate these businesses to immediate taxation on uncollected revenues. This would have severe and significant negative consequences on these businesses and their owners:

- It would result in an effective tax increase to the owners because they will be taxed on income that they have not received, without a concomitant increase in expenses.
- It will lead to significant cash-flow problems. For example, among professional services firms the primary cost is labor, and

businesses must regularly pay their employees even if they are not paid by their clients for several months. The use of cash accounting helps to mitigate this challenge by matching the timing of tax liabilities with the collection of the income being taxed.

- Cash accounting is clear and straightforward, while accrual accounting adds complexity and opacity, increasing the burdens faced by these businesses and their owners and forcing them to commit even more scarce resources to compliance efforts.

- It will impair business growth and job creation by tying up funds otherwise available for expansion.

The cash to accrual proposal undermines the core principles of tax reform: facilitating growth, creating jobs, making U.S. businesses more competitive, providing certainty and making the tax code more fair and simple. In fact, this proposal would burden relatively small businesses with complex changes in accounting practices, immediate tax increases, and unequal footing with similarly situated businesses that receive payment at the time of delivery of goods or services. We strongly urge you and the Committee to preserve the full availability of the cash method in tax reform.

Conclusion

As you move forward with tax reform, we urge support for the policy goals described above: strengthening small businesses; supporting innovative, smart, energy-efficient, and resilient development; and promoting fairness in the tax code. Tax reform following these principles would provide taxpayers with much-needed certainty, simplicity, and fairness, while at the same time encouraging economic growth and job creation.

The AIA and its members are ready to serve as a resource to you and the Committee on these and other issues. Thank you for your consideration of our comments and your leadership on these important issues.



**WRITTEN STATEMENT
OF
THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
SUBMITTED FOR THE RECORD OF THE
JULY 19, 2017
HEARING OF
THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON TAX POLICY
ON
HOW TAX REFORM WILL SIMPLIFY OUR BROKEN TAX CODE AND HELP
INDIVIDUALS AND FAMILIES**

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 1 of 10

INTRODUCTION

The American Institute of CPAs (AICPA) applauds the leadership taken by the Tax Policy Subcommittee on tax reform for individuals and families. We recognize the tremendous effort required to analyze the current complexities in the tax law, examine policy trade-offs, and consider the various reform options.

The AICPA is a long-time advocate for an efficient and effective tax system based on principles of good tax policy.¹ We need a tax system that is administrable, stimulates economic growth, has minimal compliance costs, and allows taxpayers to understand their tax obligations. These features of a tax system are achievable if principles of good tax policy are considered in the design of the system. It is also important that special care is given to transition rules and grandfathering of existing carryover rules. We note that transition rules are extremely complex, however, they are important for a smooth implementation of new tax laws. We suggest that Congress provide sufficient time to implement transition rules (e.g., alternative minimum tax (AMT) carryovers, suspended and passive losses, etc.).

In the interest of good tax policy and effective tax administration, we respectfully submit comments on tax reform issues related to individuals and families.

AICPA PROPOSALS

1. Simplified Income Tax Rate Structure

One Set of Rules

As part of the comprehensive tax reform efforts, we support a new, simplified income tax rate structure. We also suggest Congress avoid, as well as eliminate, all surtaxes which are complicated, confusing, and lack transparency. For example, the current system's requirement for taxpayers to compute their income for purposes of both the regular income tax and the AMT is a significant area of complexity in the Internal Revenue Code ("Code"). AMT requires extra calculations and recordkeeping. It also violates the transparency principle by masking what a taxpayer can deduct or exclude, as well as the taxpayer's marginal tax rate. Congress should apply a simplified rate structure with only one set of rules.

Consistent Definitions; Avoid Phase-Outs

We urge Congress to use a consistent definition of taxable income without the use of any phase-outs. The use of phase-outs, to increase the effective tax rate, has contributed to the complexity of the present tax law. Phase-outs also create marginal rates greater than the statutory rate. We are concerned that provisions to limit or eliminate the use of certain deductions and exclusions for the top tax bracket will continue the flaws of the current system.

Unnecessary complexity is added to our tax system when legislation that addresses legitimate tax policy issues is enacted without full consideration of alternatives that are less burdensome and still

¹ AICPA, "Guiding Principles for Good Tax Policy: A Framework for Evaluating Tax Proposals," January 2017.

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 2 of 10

responsive to the purposes of the legislation. While there are many examples, perhaps no situation illustrates unneeded complexity better than the proliferation of terms that have similar meanings but contain vastly different tax consequences. We recognize that there are legitimate anti-abuse justifications for differences in the application of, for example, small business status, family relationships, entity ownership, and entity attribution operating rules. However, many of these overlapping and inconsistent applications, with corresponding definitional distinctions, have existed in the Code for decades. It would reduce complexity and improve compliance if these types of provisions were identified and reduced.

2. Education Incentives

We encourage Congress to modify existing education provisions to simplify the tax incentives for higher education and help taxpayers meet current higher education expenses. Specifically, we recommend the following changes regarding education provisions.

Simplify Tax Incentives Related to Education

Replace tax incentives (*i.e.*, Hope Credit, American Opportunity Tax Credit (AOTC), and Lifetime Learning Credit) intended to help taxpayers meet current higher education expenses with one new or revised credit.

- Allow the credit on a "per student" rather than a "per taxpayer" basis, offering a potentially larger tax benefit per family.
- Allow the credit for any six years of post-secondary education, including graduate-level and professional degree courses. A credit for four years (that includes graduate-level and professional degree programs) is beneficial to many taxpayers, but we suggest increasing the limit to six years.²
- Allow the credit only for students meeting the definition of "student" under section 25A(b)(3).
- Continue to require the reporting of the Social Security Number (SSN) or other Taxpayer Identification Number (TIN) of the student associated with the expenses claimed with respect to the credit taken for the tax year. Accordingly, amounts claimed over time are tracked by the student's identification number. These changes may result in improved compliance and enforcement.
- Allow a 100% refundable credit.

² U.S. Department of Education, National Center for Education Statistics (2017). The Condition of Education 2017 (NCES 2013-144), Institutional Retention and Graduation Rates for Undergraduate Students. A report from the U.S. Department of Education stated, "about 59% of full-time, first-time students who began seeking a bachelor's degree at a 4 year institution in fall 2005 completed that degree within 6 years."

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 3 of 10

- Allow parents to claim the credit on their return provided the child is a qualifying dependent of the parent.

Repeal Section 221 and Section 222

Repeal the student loan interest deduction (section 221) and the tuition and fees deduction (section 222) to relieve taxpayer confusion by reducing the number of provisions.

Consolidate Education Savings Provisions

Repeal the interest exclusion for educational savings bonds (section 135), and merge Coverdell Education Savings Accounts (section 530) into qualified tuition programs (section 529) by allowing the transfer of savings from Coverdell accounts into section 529 accounts.

Create a Uniform Definition of "Qualified Higher Education Expenses" (QHEE)

Create a uniform definition for all education-related tax provisions. Specifically, QHEE should include tuition, books, fees, supplies and equipment. Also, if it is determined that phase-outs are necessary, all education-related tax provisions should have the same adjusted gross income (AGI) limitations.

3. Identity Theft and Tax Fraud

We support efforts to combat identity theft and tax fraud.³ The growing amount of fraudulent tax refunds paid and the economic and emotional impact to individual victims of identity theft is unacceptable.

Single Point of Contact for Identity Theft Victims

We suggest a single point of contact at the IRS for taxpayers affected by identity theft. Efficiencies will result as the single point of contact will identify areas of duplication and areas causing delays.

Criminal Penalty for Misappropriating Taxpayer Identity in Connection with Tax Fraud

We propose to make it a felony under the Code for a person to use a stolen identity to file a return. This proposal appropriately penalizes those individuals that commit the tax fraud regardless of whether a culprit is a tax preparer or someone else.

Study of Expansion of a PIN System for Prevention of Identity Theft Tax Fraud

Congress should require the IRS to provide a report to Congress on its operation and the results of the current identity protection personal identification number (IP PIN) system. This report would encourage and support the expansion of the IP PIN system, which is currently used on a limited basis, to help prevent identity theft.

Internet Platform for Forms 1099 Filings

We recommend that Congress instruct the Department of the Treasury ("Treasury") to make available a website or other electronic medium to allow taxpayers to securely prepare, file and distribute Forms 1099. The website will reduce the cost of compliance, accelerate the receipt of

³ AICPA letter, "[Chairman's Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud](#)," September 15, 2015.

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 4 of 10

information and enable the IRS to more efficiently and effectively match reported amounts against individual tax returns.

4. "Kiddie Tax" Rules

The AICPA recommends repealing the provisions linking a child's taxable income to his/her parents' and siblings' taxable income. Income (other than capital gains) subject to this tax should use the income tax rates for estates and trusts. Income from capital gains should use the capital gains rates with one change; the 0% rate for capital gains should not apply to children's unearned income. Removing the linkage to parental and sibling returns would allow a child's return to stand on its own, removing complications due to missing information on one return, matrimonial issues, and unintended AMT problems.

We also recommend eliminating the election to include a child's income on the parent's return to facilitate the complete de-coupling of the link between the computation of the child's tax liability and the parent's tax liability.

Section 1(g) of the Code taxes a portion of the unearned income of a child⁴ at the parent's marginal tax rate ("Kiddie Tax").⁵ Specifically, the provision applies in cases where (1) the child's unearned income was more than \$2,000 (indexed); (2) the child is required to file a tax return; (3) either parent of the child is alive at the close of the year; and, (4) the child does not file a joint return for the taxable year.

Section 1(g)(6) requires the parent to provide his/her TIN to the child for inclusion on the child's tax return. Parents can elect to include their children's interest and dividend income (including capital gain distributions) on their tax return. However, the election is not available for parents of a child if the child has any earned income, unearned income of \$10,500 or more (for 2016), unearned income other than interest, dividends and capital gain distributions, withholding, or estimated tax payments.

The Kiddie Tax adds significant complexity to the computation of a child's tax liability⁶ and several challenges arise in complying with the rules of the statute:

- Parents may refuse to provide the tax rate. Without this information, the tax preparer is forced to calculate the child's tax at the highest rate.

⁴ A child is defined as any child who is (1) under the age of 18; (2) age 18 at the end of the year and who did not have earned income that was more than half of the child's support; or, (3) a full-time student under the age of 24 who did not have earned income that was more than half of the child's support.

⁵ The marginal tax rate of the individual with the greater taxable income is used in the case of parents filing separately. When parents who are not married, the marginal tax rate of the custodial parent is used to determine the tax liability on net unearned income. Net unearned income is the amount of unearned income above \$1,000 plus the greater of \$1,000 or itemized deductions directly connected to producing unearned income. When the provisions of section 1(g) apply to more than one child in the family, each child's share of the parental tax is apportioned ratably based on the ratio of the child's net unearned income to the total net unearned income of all children.

⁶ Due to complexity, IRS issued [Publication 929](#) to assist with calculating child's taxable income and tax liability.

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 5 of 10

- The Internal Revenue Service (IRS or "Service") requires qualified dividends and capital gain distributions to allocate between the first \$2,100 (in 2016) of unearned income and the portion of the child's unearned income over \$2,100, thus making the computation burdensome.
- If the parents or siblings file amended returns, the child must file an amended return.
- The Kiddie Tax provisions only consider regular tax and not AMT resulting in the child's income taxed at a higher rate than applies to the parent.

The additional tax revenue generated by the Kiddie Tax is insignificant when compared to the complexity of the calculations. Taxing the net unearned income of a child at the tax rates for estates and trusts rather than at a rate linked to that of family members would eliminate a significant amount of complexity and several compliance challenges, while still accomplishing the original intent behind the Kiddie Tax.⁷

5. Permanent Disaster Relief

Permanent Disaster Relief Tax Provisions

Without established relief through the tax code system (e.g., allowing casualty losses and medical expenses in the year of death) catastrophic and involuntary type situations can affect people's ability to pay their taxes. Therefore, the AICPA urges Congress to enact permanent tax legislation that would take effect immediately when a declaration of a federal disaster occurs, rather than providing delayed tax relief through separate individual bills following each disaster. We have previously submitted comments on the need for permanent tax provisions that are triggered when a taxpayer resides, or has a principal place of business located, in a Federal Emergency Management Agency's (FEMA) "Disaster Declaration"⁸ area for which individual "Disaster Assistance"⁹ is available.

We recommend the following permanent tax provisions applicable to individuals and families:

- *Waive Individual Casualty Loss Limitations*
 Waive the casualty loss floor of 10% of AGI (section 165(h)(i)) and the \$100 per loss floor (section 165(h)(2)) for losses attributable to a disaster event. The purpose of this provision is to extend adequate relief to the affected taxpayers under section 165(h)(i).
- *Increase Property Replacement Period to Five Years*
 Allow a five year replacement period (increased from two) under section 1033(a)(2)(B) for property damaged or destroyed by a disaster event. For certain disasters that have occurred,

⁷ The Tax Reform Act of 1986 lowered tax rates and broadened the income tax base by eliminating various tax shelters used by high income individuals.

⁸ Federal Emergency Management Agency's [Disaster Declarations](#).

⁹ FEMA Disaster Assistance information is included in the [Disaster Assistance and Emergency Relief Program for Individuals and Businesses](#).

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 6 of 10

a five year replacement period is already in place. This provision makes five years the standard replacement period. Also, allow this revision to the replacement period to cover trade/business property, real property, and/or principal residences that are involuntarily converted during a disaster event.

- *Waive the Penalty for Early Retirement Withdrawal*
 Impose no tax on qualified disaster victims who withdraw up to a specified amount (\$100,000) from a qualified plan or individual retirement account (IRA) and repay that amount within five years. Any amount not repaid within five years of the date of withdrawal is taxable income during that fifth year unless a taxpayer chooses to report the amount as income and pay the tax in any earlier year. Any income recognized under this section is not subject to the 10% early withdrawal penalty under section 72(t) for distributions up to a specified amount (\$100,000). Such favored distributions were previously allowed under section 1400Q(a) for hurricane disasters; however, this provision would include all federally declared disaster events, including but not limited to hurricanes. One purpose of this provision is to allow affected taxpayers to access their own funds immediately while waiting for government assistance and insurance reimbursements that are not immediately forthcoming.
- *Allow a Housing Exemption for Displaced Individuals*
 Allow a partial or full exemption (as defined under section 151(d)) to individuals who provide at least 60 days of temporary rent-free housing to a person dislocated by a disaster event. Taxpayers may claim this exemption only once for each such persons and shall claim the exemption for the tax year which contains the latter of the 60th day or the day that the temporary housing period ends. The exemption amount is calculated as the number of rent-free days (up to 365) provided divided by 365 and multiplied by the personal exemption allowed a single taxpayer during the applicable year. The maximum number of individuals for which a taxpayer may claim this exemption is four individuals per disaster event. Furthermore, no phase-out under section 151(d)(3) would apply to this exemption.
- *Allow Discharge of Indebtedness*
 Allow disaster victims to exclude from taxable income, under section 108, cancellation of debt income for non-business debts provided that the cancellation occurs within one year of the beginning date of the disaster event. The discharging entity must certify that the discharge is a direct result of loss, property damage, or other factors caused exclusively by the disaster event. Currently, the Code provides only limited exclusions for discharge of indebtedness income. This recommendation would allow for a necessary provision recognizing that if individuals affected by a disaster are unable to repay their outstanding loans, they are also likely unable to pay tax on the phantom income.
- *Permit the Use of Prior Year's Income to Calculate the Earned Income Tax Credit (EITC), Child Tax Credit (CTC), and Premium Tax Credit*
 Allow affected taxpayers in the disaster area to use either their current year or previous year's income amounts for purposes of calculating the EITC (section 32), the CTC (section 24) and the Premium Tax Credit (section 36B). With this suggested provision, the affected

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 7 of 10

taxpayer would have the opportunity to use a more beneficial income year, thus allowing the affected taxpayer the opportunity to benefit from various credits that might not have been available to the taxpayer because of the fluctuation of income caused by the disaster.

- *Increase the Medical Expense Deduction*
 Eliminate the medical deduction floor percentage (as defined under section 213(a), generally 10% of AGI) for an individual who incurs deductible medical expenses directly related to an injury caused by the disaster event. This reduction is available only for the directly-related expenses incurred for up to two tax years (the year of the event and the subsequent year). The purpose of this provision is to provide relief from the deduction limitations for taxpayers incurring unexpected disaster related medical expenses.

We suggest adjusting annually for inflation, any dollar amount provided in permanent disaster relief provisions.

IRS Deadlines Related to Disasters

Similar to the authority of the IRS to postpone certain deadlines in the event of a presidentially-declared disaster, Congress should extend that limited authority to state-declared disasters and states of emergency. We recommend that Congress allows the IRS to postpone certain deadlines in response to state-declared disasters or states of emergency.

Currently, the IRS's authority to grant deadline extensions, outlined in section 7508A, is limited to taxpayers affected by federally-declared disasters. State governors will issue official disaster declarations promptly but often, presidential disaster declarations in those same regions are not declared for days, or sometimes weeks after the state declaration. This process delays the IRS's ability to provide federal tax relief to disaster victims. Individuals can request waivers of penalties on a case-by-case basis; however, this process causes the taxpayer, tax preparer, and the IRS to expend valuable time, effort, and resources which are already in shortage during times of a disaster. Granting the IRS specific authority to quickly postpone certain deadlines in response to state-declared disasters allows the IRS to offer victims the certainty they need as soon as possible.

6. Tax Administration

Modernize Internal Revenue Service

Whether addressed within or outside of tax reform, we urge Congress to address IRS taxpayer services, and recommend that any effort to modernize the IRS and its technology infrastructure should build on the foundation established by the [Report of the National Commission on Restructuring the IRS](#).

As tax professionals, we represent one of the IRS's most significant stakeholder groups.¹⁰ As such, we are both poised and committed to being part of the solution for improving IRS taxpayer

¹⁰ 60% of all e-filed returns in 2016 were prepared by a tax professional, according to the [Filing Season Statistic for Week Ending Dec. 2, 2016](#).

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 8 of 10

services. In April, we submitted a letter¹¹ to House Ways and Means Committee and Senate Finance Committee members in collaboration with other professional organizations. Our recommendations include modernizing IRS business practices and technology, re-establishing the annual joint hearing review, and enabling the IRS to utilize the full range of available authorities to hire and compensate qualified and experienced professionals from the private sector to meet its mission. The legislative and executive branches should work together to determine the appropriate level of service and compliance they want the IRS accountable for and then dedicate appropriate resources for the Service to meet those goals.

Additionally, we recommend that Congress direct the IRS to create a new dedicated practitioner services unit to rationalize, enhance, and centrally manage the many current, disparate practitioner-impacting programs, processes, and tools. Enhancing the relationship between the IRS and practitioners would benefit both the IRS and the millions of taxpayers served by the practitioner community. As part of this new unit, the IRS should provide practitioners with an online tax professional account with access to all of their clients' information. The IRS should offer robust practitioner priority hotlines with higher-skilled employees who have the experience and training to address complex issues. Furthermore, the IRS should assign customer service representatives (a single point of contact) to geographic areas in order to address challenging issues that practitioners could not resolve through a priority hotline.

Due Diligence Requirements

The Protecting Americans from Tax Hikes Act ("PATH Act,") (P.L. 114-113 (12/18/15)) added the CTC and the AOTC to the due diligence requirements of paid preparers for the preparation of tax returns that claim these refundable credits. This new requirement for paid preparers involves completing Form 8867, *Paid Preparer's Due Diligence Checklist*, a form that many tax preparers were already required to complete for returns where the EITC was claimed.

However, this additional checklist (Form 8867) is an unnecessary burden to professional preparers who are already subject to multiple levels of due diligence requirements. These existing requirements include the section 6694 preparer penalty regulations, the Treasury's Circular 230 rules, professional association ethical standards, and state licensing board regulations.

The AICPA recommends that Congress modify section 6695(g) by adding an additional sentence as follows:

"The Secretary must consider simplified approaches that recognize that taxpayers are responsible for the accuracy of their return and that certain tax return preparers are already subject to additional due diligence requirements."

Information Reporting and Forms 1099

Taxpayers and the tax practitioner community are burdened by the growing volume of corrected and delayed information returns. Taxpayers receiving corrected Forms 1099 are obligated to file amended tax returns in order to report the corrected amounts. This process compresses the tax

¹¹ AICPA letter, "Ensuring a Modern-Functioning IRS for the 21st Century," April 3, 2017.

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 9 of 10

filing season and causes time-consuming and expensive efforts for corrections that often result in insignificant differences.

- *De Minimis Error Safe Harbor for Taxpayers (Recipients of Information Returns)*
 Congress should not require taxpayers that receive corrected information returns to file amended tax returns for relatively minor dollar amounts. Under the current rules, there is a *de minimis* safe harbor established under sections 6721 and 6722 which only applies to the issuers of information returns. However, there is no safe harbor for recipient taxpayers. If the issuer decides to issue a corrected Form 1099 for an immaterial amount (even if not required), the taxpayer must file an amended tax return.

The AICPA recommends adding a *de minimis* safe harbor for recipients of corrected information returns such that small changes do not require the filing of amended Form 1040, *U.S. Individual Income Tax Return*, Form 1041, *U.S. Income Tax Return for Estates and Trusts*, Form 1065, *U.S. Return of Partnership Income*, Form 1120-S, *U.S. Income Tax Return for an S Corporation*, or Form 1120, *U.S. Corporation Income Tax Return*. Thus, if corrected amounts on any information return do not change by more than \$100 or change tax withholding by more than \$25, the recipient of the corrected information return would not incur penalties for failure to file an amended tax return (these are the same *de minimis* amounts used for issuers at sections 6721 and 6722). A *de minimis* safe harbor for recipients would reduce burdens on taxpayers and practitioners who repeatedly correct returns and reduce the expenditure of IRS resources in processing these returns.

- *Simplification for Issuers of Information Returns*
 Under Notice 2017-09, penalties are waived if an error made by the payor (or "issuer") in the preparation of information returns does not exceed \$100 or an error in reporting taxes withheld does not exceed \$25. However, if the payee (recipient of the incorrect information return) elects to receive a corrected statement and if one is not issued, the penalty is not automatically waived.

The election process outlined in the statute and notice creates compliance burdens for information return issuers¹² since they need to track if elections were made to waive the *de minimis* error safe harbor. The AICPA proposes a simplified approach for the *de minimis* error safe harbor rules under sections 6721 and 6722 applicable to issuers of information returns, as follows:

- If a recipient of an information return notifies the issuer of an error, the issuer has thirty days in which to provide a corrected document to the recipient. If the issuer fails to provide a corrected document, it is subject to the penalties (unless the IRS determines there is other justification for a penalty waiver).¹³

¹² Many information return issuers are large brokerage firms with thousands of individual recipients.

¹³ Issuers could still file corrected information returns addressing *de minimis* errors.

AICPA's Written Statement for the Record
 U.S. House Ways and Means Committee, Tax Policy Subcommittee
 July 19, 2017 Hearing on "How Tax Reform Will Simplify Our Broken Tax Code and Help
 Individuals and Families"
 Page 10 of 10

- Recipients of incorrect information returns have 18 months from the original issuance date to request corrected information returns from the issuer.¹⁴ This timeline protects issuers from incurring penalties many years past their original year of error.
- Allow reporting entities (including employers, partnerships, S corporations, estates and trusts) to have the ability to "rollover" small information return errors, contained on Forms 1099 and W-2 and Schedules K-1, in the following year, rather than filing amended or corrected forms. We propose that Congress provides an exception to file or furnish a corrected information return in the current year if a single error amount differs from the correct amount for a recipient by no more than \$200 in income. The reporting entity would report the differential amount in the year following the error. The identified error and corrected information should also include the original date and transaction to which it relates.
- *Corrected and Late Forms 1099*
 An important concern to both taxpayers and tax preparers is also the growing problem of delayed information reporting. Tax filing seasons have become increasingly challenging for practitioners because brokerage firms issue "preliminary" Forms 1099. The "final" versions of these forms are generally provided after the February 15th information reporting deadline. Additionally, some brokerage firms have begun to routinely, each year, request extensions from the IRS to issue Forms 1099 after the reporting deadline. Congress should require the IRS to publicly release, on the IRS.gov website, an updated list of the brokers and other information reporting agents that received an IRS extension beyond the information reporting due date.

CONCLUDING REMARKS

The AICPA has consistently supported tax reform simplification efforts because we are convinced such actions will reduce compliance costs and fuel economic growth. The AICPA appreciates the opportunity to submit this written testimony and we look forward to working with the Subcommittee as you continue to address the needs of individuals and families.

The AICPA is the world's largest member association representing the accounting profession with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state, local and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

¹⁴ Section 6722(c)(2)(B) would need to include this time limit.

Chair:
Ms. Barbara A. Boiegrain

Secretary/Treasurer:
Mr. Andrew Q. Hendren, Esquire

Wespath Benefits and Investments
1901 Chestnut Avenue
Glenview, Illinois 60025
(847) 866-4200

Chair Emeritus:
Mr. John G. Kapanke

Members:

Rev. Todd Adams
Disciples of Christ
Mr. Louis Barbarin*
American Baptist Churches
Mr. Brian Bodager
United Church of Christ
Ms. Barbara A. Boiegrain*
United Methodist Church
Mr. John H. Bolt
Christian Reformed Church in North America
Mr. John Brummitt
National Association of Free Will Baptists
Mr. Gary D. Campbell
Presbyterian Church in America
Mr. Nevin Dulabaum
Church of the Brethren
Dr. Craig A. Dunn
Wesleyan Church
Dr. O. S. Hawkins*
Southern Baptist Convention
Mr. Paul Hawkinson
Evangelical Covenant Church
Mr. Jeffrey A. Jenness*
Board of Pensions of the Church of God
Rev. Dr. Jeffrey J. Jeremiah
Evangelical Presbyterian Church
Mr. Raymond Jimenez
General Conference of Seventh-Day Adventists
Mr. Mario J. Kauffman
Mennonite Church
Mr. Michael Kimmel
Reform Pension Board
Ms. Michelle McGrath
Community of Christ
Rev. Ross I. Morrison
Evangelical Free Church of America
Rev. Richard Nugent
Unitarian Universalist Association
Ms. Kelly Oliveira
Reformed Church in America
Mr. Joshua Peterman
Wisconsin Evangelical Lutheran Synod
Mr. Jonathan Phillips
International Church of the Foursquare Gospel
Mr. John M. Preis*
Young Men's Christian Association
Br. Michael F. Quirk, FSC*
Christian Brothers Services
Mr. Arthur D. Rhodes
Church of God Benefits Board
Mr. Larry Roberts
Free Methodist Church of North America
Mr. James F. Sanft*
Lutheran Church-Missouri Synod
Mr. Stephen Schultz
Baptist General Conference-Converge Worldwide
Mr. Mitchell J. Smilowitz*
Joint Retirement Board for Conservative Judaism
Rev. Frank C. Spencer*
Presbyterian Church (U.S.A.) Board of Pensions
Mr. Ray D. Stiles
Christian Churches Pension Plan
Rev. Jeffrey Thiemann*
Evangelical Lutheran Church in America
Mr. James P. Thomas, CPA
Churches of God, General Conference
Rev. Bruce Verkuysse, Jr.
Association of Unity Churches International
Rev. Don L. Walter
Church of the Nazarene
Mr. Roger Wiles
Associate Reformed Presbyterian Church
Ms. Mary Kate Wold*
Episcopal Church

* Steering Committee Members

CHURCH ALLIANCE

Acting on Behalf of Church Benefits Programs

Counsel:
K&L Gates LLP
1601 K Street NW
Washington D.C. 20006
Tel (202) 778-9000
Fax (202) 778-9100

August 2, 2017

The Honorable Peter Roskam
Chairman
House Committee on Ways and Means
Subcommittee on Tax Policy
2246 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
House Committee on Ways and Means
Subcommittee on Tax Policy
2307 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett:

The Church Alliance is pleased to submit the following statement for the record in response to the House Ways and Means Subcommittee on Tax Policy's July 19, 2017 hearing on *How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families*. As you know, churches, synagogues, and other religious organizations are at the heart of communities across our nation. Over the years, a number of important tax provisions have developed that reflect the unique characteristics of these institutions, particularly in the areas of health and retirement security. We look forward to working with you and your staff to pursue comprehensive tax reform that preserves the spirit of these provisions, and helps all Americans save and invest for their future.

ABOUT THE CHURCH ALLIANCE AND CHURCH BENEFIT PLANS

The Church Alliance is a coalition of chief executive officers of thirty-seven (37) denominational benefit programs, covering mainline and evangelical Protestant denominations, two branches of Judaism, and Catholic schools and institutions. These benefit programs provide retirement and health benefits to more than one million clergy (including ministers, priests, rabbis, and other spiritual leaders), lay workers, and their family members.

By way of background, denominational benefit plans are typically maintained by a separately incorporated church benefit organization (often called a pension board or benefit board) designated as the entity that sponsors or administers and maintains the benefit programs for eligible employees within the denomination. These benefit plans are generally multiple-employer in nature and cover thousands of church and

synagogue employers throughout the country, many of which are located in rural communities. These programs often also cover foreign mission organizations and their missionaries. Church benefit organizations thus typically provide retirement and welfare benefits to thousands (or, in the case of the larger denominations, tens of thousands) of clergy and lay workers at multiple locations. Having a centralized program sponsored by one organization serving multiple church employers helps ensure continuity and consistency of employee benefits for the many clergy who move from one church or church-related organization to another to fulfill the ministry of a denomination.

The participating employers covered under these church benefit plans range from synagogues and churches to church-affiliated schools, day cares, and nursing homes. Many are small, local churches with few employees. Oftentimes, the local church's pastor may be that church's only employee. If there are other employees, they are often part-time workers who assist with secretarial or bookkeeping duties or perhaps provide for building maintenance. In addition, many small local churches are staffed by bi-vocational pastors (clergy who work for a secular employer part-time or full-time and pastor a church or churches on the side). Denominational plans also provide benefits to self-employed clergy.

In addition to serving local churches and synagogues, denominational benefit plans cover other church-related organizations that historically have been viewed by denominations as an extension of the ministry and are considered to be within the bounds of the particular denomination with which they are affiliated. For example, participating employers can include church-related nursing homes, daycare centers, summer camps, preschools, colleges, universities, hospitals, and other social service organizations. All of these organizations typically are considered as fulfilling the ministry and mission of the church.

Local churches are typically run by volunteer trustees, vestries, boards of directors, boards of deacons, boards of elders, parish councils, or the like. The individuals who hold these volunteer leadership roles are focused on fulfillment of their church's ministry and have the burden of allocating both human and monetary resources to direct ministry, which leaves them with little time to focus on employee benefit compliance issues. In the case of small to medium-sized churches and synagogues, these individuals may, and usually do, lack the expertise required to understand the various employee benefit legal requirements that must be met. Except in the largest churches, the typical church budget does not support the hiring of outside experts required to assist the local church with employee benefits compliance. As a result, absent the availability of the programs provided through church benefit organizations and church associations, many of these employers would be unable to provide adequate retirement or welfare benefits to their employees.

The benefits provided by church benefit organizations or church associations may be mandated by the denominational polity (the operational and governance structure of a denomination). Over the years, church denominations have organized themselves in a variety of

ways reflecting their own theological beliefs. Some denominations are organized in a “hierarchical” polity, in which a “parent” church organization sets the policy for the entire denomination. Other denominations have organized themselves in a diocesan, synodical or presbyterian structure under which policy-making is carried out on a local or regional level, through representatives drawn from the various churches within the geographic area served by a particular level of governance. Several other denominations, composed of autonomous churches and synagogues, or conventions or associations of churches, cooperate in a “congregational” form of governance in which churches and church ministry organizations are associated by voluntary and cooperative participation.

It is these diverse sets of church polities, and the differing levels of control exercised over churches and church ministry organizations under a particular polity, that present difficulties with employee benefit requirements of the tax code, ERISA, and other laws, most of which were designed with a for-profit, corporate structure in mind. Together with the Constitutional proscription against excessive government entanglement with religion, these considerations have led to the development of a legal framework for church plans that reflects their unique characteristics.

PRIORITIES FOR TAX REFORM

Central to this legal framework are several longstanding provisions of the tax code that have been carefully tailored to the needs of churches and church ministry organizations. Retaining and strengthening these provisions is critical to the retirement security of modestly-paid clergy and others who have devoted their lives to ministry. In addition, a comprehensive federal framework is important to promote clarity and consistency for church plans nationwide. As you move forward with tax reform, we urge your attention to the following issues.

CLARIFICATION FOR § 403(b)(9) PLANS

Clarification of the rules governing church retirement plans is urgently needed to reaffirm current law dating to 1980, and more than 30 years of administrative practice to ensure that all church-affiliated organizations can participate in a church § 403(b)(9) plan. Throughout their history, the advantages of church retirement plans have been open to church clergy and lay workers serving individual churches, as well those of affiliated organizations that advance the mission of the denomination, such as children’s homes, daycare centers, summer camps, nursing homes, retirement centers, preschools, colleges and universities, and other religious nonprofit entities.

The broad availability of these plans is now under threat by a recent IRS and Treasury position that departs from longstanding precedent to restrict the retirement plan options available to employees of certain religiously-affiliated organizations. Under this interpretation, employees of these organizations will no longer be able to participate in § 403(b)(9) plans. This has

significant drawbacks for church retirement plans, but most importantly, for the beneficiaries they serve.

The IRS and Treasury interpretation could mean that clergy and church lay workers lose access to important § 403(b)(9) features, such as access to socially screened investment options that reflect a particular denomination's faith and beliefs, as well as to annuitization choices that can be provided directly by the church benefit program. Moreover, this approach would inevitably lead to higher costs with fewer § 403(b)(9) plan participants over which to spread plan expenses.

Recognizing these implications, bipartisan, broadly supported legislation has been introduced in the House and Senate (H.R. 2341 / S. 674) to clarify the appropriate and intended broad availability of § 403(b)(9) plans. We strongly urge enactment at the earliest possible opportunity, either independently or as part of tax reform. Urgent resolution of this issue is critical to the retirement security of clergy and church lay workers across the nation.

PARSONAGE ALLOWANCE

For nearly 100 years, exclusion from taxation of church-provided housing to clergy has reflected the long-held belief that a clergy member's home is an extension of the church. In addition, the parsonage allowance under § 107 has been important in helping modestly-paid clergy and retired clergy afford housing and move, sometimes frequently, to serve the needs of the church. This is particularly true in rural areas where many congregations are small, pay is low, and clergy are very dependent upon their churches providing or paying for their housing. This important tax policy is subject to commonsense limitations on the rental value of the home subject to the allowance, and applies to just a single property.

Moreover, the parsonage allowance must be viewed in the context of § 119, which excludes secular employer-supplied housing from employees' income under certain circumstances (e.g., an on-site hotel manager's housing). However, as applied to clergy, some § 119 criteria would produce unequal results between denominations that have different theological and polity based practices relating to clergy and housing. § 107 allows clergy of all faiths to share equally in this important tax policy.

Given the continuing need for the parsonage allowance, we strongly urge its preservation as part of tax reform.

RETIREMENT PLAN STREAMLINING/CONSOLIDATION

As described above, church retirement plans have evolved, in some cases over hundreds of years, to reflect the unique characteristics of the denominations and populations they serve. The benefits provided by church plans are often mandated by the denominational polity (the operational and governance structure of a denomination), and are tailored to meet the needs of

clergy and church lay workers who are often modestly paid. Over time, laws have been developed to work with a variety of diverse denominational structures, and to allow employees of religiously-affiliated institutions to have a meaningful opportunity to save for retirement in a manner that comports with their faith.

In this context, proposals to streamline or consolidate the various retirement plan options under the tax code (401(a), 403(b), 401(k), 457(b), etc.) threaten to eliminate provisions that church plans have come to rely upon in providing a secure, stable retirement for their beneficiaries. We caution against any streamlining or consolidation proposal that would undermine these provisions, which would also create severe compliance challenges (in some cases making the plans untenable) and burdensome transition costs for church plans and church-affiliated organizations. Specifically, we urge your preservation of the following provisions that are instrumental to the retirement security of often modestly-paid clergy and lay workers:

- **Different nondiscrimination testing rules.** 403(b) plans maintained by churches and qualified church-controlled organizations are exempt from nondiscrimination rules, based upon Congress's recognition of the difficulty that churches run by volunteers would have in assuring compliance with complex rules without directing their scarce resources away from mission activities; in contrast, plans maintained by larger, more sophisticated non-qualified church-controlled organizations are subject to nondiscrimination testing rules. Similarly, in recognition of the difficulty that church plans have in satisfying certain nondiscrimination rules due to their unique structures, the IRS granted an extension to the effective date of certain nondiscrimination regulations as applicable to church 401(a) qualified plans. These policies reflect the unique workforce characteristics of churches and church-related organizations.
- **Exemptions for church 401(a) plans.** With respect to defined benefit plans, the tax code reflects a number of accommodations to the unique structure of religious denominations and the plans they have designed to assure retirement security of clergy and church workers serving as called throughout their career by their denominations. These tax code provisions allow missionaries, self-employed clergy and chaplains to participate and exempt church plans from various of the qualification requirements applicable to private plans.¹ These exemptions are important because many of the rules that would conflict

¹ Church 401(a) plans are not subject to numerous plan qualification requirements including, qualified joint and survivor annuities under §§401(a)(11) and 417; preservation of accrued benefits during a plan merger or transfer of plan assets under §§401(a)(12) and 414(l); anti-alienation rules of §401(a)(13); benefit commencement requirements of §401(a)(14); the prohibition on reducing retiree vested benefits due to Social Security increases under Code §401(a)(15); and the prohibition on forfeiture of accrued benefits from employer contributions due to withdrawal of employee contributions under Code §401(a)(19), if the employee is 50% vested. Church plans are subject to the pre-ERISA minimum participation standards, minimum vesting standards and minimum funding standards and exempt from the anti-cutback requirements of §411(d)(6). Church plans also have relaxed standards for defining a highly compensated employee under Code §414(q)(9) and domestic relations orders under Code §414(p). There are also specialized or relaxed rules pertaining to churches in computing the limits on employee contributions under Code §§401(a)(17), 402(g)(7) and 415(c)(7).

with the design of plans established to meet the needs of these workers decades ago or otherwise would be unworkable in the decentralized, polity-driven context of a denominational church plan.

- **Flexible investment options for church plans.** Church plans offer broad latitude for denominational benefit organizations (or their investment committees, which are typically composed of individuals with substantial investment expertise) to offer an array of investment alternatives beyond annuity contracts and mutual funds, such as pooled investments in stocks, bonds, collective investment funds and other prudent options that benefit from lower fees and economies of scale. Many church plans also further the missions of their respective denominations by incorporating faith-based screens and positive social purposes in their investment decisions.
- **Self-annuitization feature for church 403(b)(9) plans.** IRS regulations permit sponsors of church defined contribution 403(b)(9) plans to “self-annuitize” benefits, providing valuable flexibility and stability through lifetime retirement income, at a lower cost to participants than purchasing annuities from a commercial issuer. Churches practice their commitment to care for those that serve the church by using these provisions to support these faithful servants and their surviving spouses.
- **Special annual addition limits for church 403(b) plans.** Some church employees and missionaries may have little or no taxable income due to very low compensation. Consequently, church 403(b) plans provide a special annual addition limit of \$10,000 per year (subject to a lifetime maximum of \$40,000), regardless of the beneficiary’s taxable income. This provides clergy, lay workers, and missionaries with an opportunity to create retirement benefits while performing vital church mission work, notwithstanding their low taxable income.
- **Definition of compensation.** The limits on contributions under the different types of plans are based in part on a participant’s compensation. For this purpose, compensation is defined slightly differently with respect to 403(b) plans. The differences are attributable to special rules that should be retained, such as the ability to treat former employees as having compensation for five years (§ 403(b)(3)), and the treatment of clergy (§ 414(e)(5)(B)). From a policy perspective, there is no reason to harm either clergy or former church employees who may need additional retirement savings.
- **Direct contributions by self-employed clergy.** Certain chaplains and self-employed clergy are authorized to make direct contributions to a church plan. Contributions to a § 403(b)(9) plan are deductible by clergy under § 404(a)(10). This is a valuable retirement savings option for clergy who might otherwise lack the opportunity to participate in a church plan.

QUALIFIED RETIREMENT PLAN PARITY WITH IRAS

Church retirement plans are disadvantaged relative to Individual Retirement Accounts (“IRAs”) in several important respects. First, participants are eligible to make a tax-free Qualified Charitable Distribution (“QCD”) directly from an IRA to a charity, but are not permitted to do so from a church retirement plan. Church plans should be allowed to facilitate tax-free QCDs for their members and beneficiaries, making it easier for clergy and other church workers to engage in charitable giving.

In addition, IRAs and church retirement plans are treated dissimilarly regarding required minimum distributions (“RMDs”). The rules applicable to IRAs are more equitable, basing the RMD amount on the age of the recipient. Church retirement plans should be able to offer the same equitable treatment for a clergy member’s surviving spouse.

CORPORATE INTEGRATION

The Church Alliance understands and appreciates the goal of greater parity between the corporate and passthrough tax systems. However, the way in which Congress pursues this goal could have significant implications for churches and other tax-exempt charitable organizations. Specifically, we urge you to avoid any approach to corporate integration that would result in the imposition of new taxes on the earnings that these organizations receive from their investment portfolios. Increased taxation could limit returns to church benefit plan participants, eroding the stability of their retirement. We encourage you to be cognizant of the interaction with the tax exemption for non-profit organizations as you consider corporate integration proposals.

ROTH TREATMENT

Finally, we have taken note of recent discussions about potential limitations on the amount of pre-tax elective deferral contributions to certain retirement plans; contributions in excess of these limits would be treated as post-tax or “Roth” contributions. We have serious concerns that, in addition to not yielding any “real” additional revenue for the government (as it would merely shift the timing of collection, not the incidence of taxation), these proposals could significantly reduce the incentives to save for retirement. This could have severe consequences, particularly for modestly-paid individuals who might not otherwise save for retirement absent the tax incentive provided by deferral.

Like you, we strongly believe that tax reform should make it easier and more compelling for Americans to save and invest for their future – not the other way around. We encourage you to pursue policy solutions that achieve this goal, rather than ones that could frustrate it.

* * *

In closing, the Church Alliance greatly appreciates the opportunity to submit these comments. We are pleased to serve as a resource to the Congress and the Committee on these and related matters. We look forward to our continued work together on these important issues as comprehensive tax reform moves forward. Thank you for your consideration.

Sincerely,



Barbara A. Boigegrain
Chair of the Church Alliance

August 2, 2017

The Honorable Peter Roskam
Chairman
House Committee on Ways and Means
Subcommittee on Tax Policy
2246 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
House Committee on Ways and Means
Subcommittee on Tax Policy
2307 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Roskam and Ranking Member Doggett:

On behalf of the Coalition to Preserve Cash Accounting (“the Coalition”), we are writing to explain why it is important to continue to allow farmers, ranchers, and service provider pass-through businesses to continue to use the cash method of accounting as part of any tax reform plan. We appreciate the opportunity to provide these comments in connection with the House Ways and Means Subcommittee on Tax Policy’s July 19, 2017 hearing on *How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families*. The Coalition applauds your efforts to improve the nation’s tax code to make it simpler, fairer and more efficient in order to strengthen the U.S. economy, make American businesses more competitive, and create jobs.

The Coalition is comprised of dozens of individual businesses and trade associations representing thousands of farmers, ranchers, and service provider pass-through entities across the United States that vary in line of business, size and description, but have in common that our members rely on the use of cash accounting to simply and accurately report income and expenses for tax purposes. Pass-through entities account for more than 90 percent of all business entities in the United States. A substantial number of these businesses are service providers, farmers, and ranchers that currently qualify to use cash accounting. They include a variety of businesses throughout America - farms, trucking, construction, engineers, architects, accountants, lawyers, dentists, doctors, and other essential service providers - on which communities rely for jobs, health, infrastructure, and improved quality of life. These are not just a few big businesses and a few well-to-do owners. According to IRS data, there are over 2.5 million partnerships using the cash method of accounting, in addition to hundreds of thousands of Subchapter S corporations eligible to use the cash method.

About the Cash Method of Accounting

Under current law, there are two primary methods of accounting for tax purposes - cash and accrual. Under cash basis accounting, taxes are paid on cash actually collected and bills actually paid. Under accrual basis accounting, taxes are owed when the right to receive payment is fixed, even if that payment will not be received for several months or even several years; expenses are deductible even if they have not yet been paid.

The tax code permits farmers, ranchers, and service pass-through entities (with individual owners paying tax at the individual level) of all sizes - including partnerships, Subchapter S

corporations, and personal service corporations - to use the cash method of accounting. Cash accounting is the foundation upon which we have built our businesses, allowing us to simply and accurately report our income and expenses, and to manage our cash flows, for decades. It is a simple and basic method of accounting - we pay taxes on the cash coming in the door, and we deduct expenses when the cash goes out the door. No gimmicks, no spin, no game playing. Cash accounting is the very essence of the fairness and simplicity that is on everyone's wish list for tax reform.

Some recent tax reform proposals would require many of our businesses to switch to the accrual method of accounting, not for any policy reason or to combat abuse, but rather for the sole purpose of raising revenues for tax reform. Forcing such a switch would be an effective tax increase on the thousands upon thousands of individual owners who generate local jobs and are integral to the vitality of local economies throughout our nation. It would also increase our recordkeeping and compliance costs due to the greater complexity of the accrual method. Because many of our businesses would have to borrow money to bridge the cash flow gap created by having to pay taxes on money we have not yet collected, we may incur an additional cost with interest expense, a cost that would be exacerbated if interest expense is no longer deductible, as proposed under the House Republicans' Better Way blueprint ("the blueprint"). Some businesses may not be able to borrow the necessary funds to bridge the gap, requiring them to terminate operations with a concomitant loss of jobs and a harmful ripple effect on the surrounding economy.

Tax Reform Proposals and Cash Accounting

The blueprint moves toward a cash flow, destination-based consumption tax. The cash flow nature of the proposal suggests that the cash method of accounting would be integral and entirely consistent with the blueprint since it taxes "cash-in" and allows deductions for "cash-out," including full expensing of capital expenditures. While we understand that they are different proposals, the "ABC Act" (H.R. 4377), a cash flow plan introduced by Rep. Devin Nunes (R-CA) in the 114th Congress, *required* all businesses to use the cash method. However, the blueprint does not provide details regarding the use of the cash method, including whether all businesses would be required to use it, whether businesses currently allowed to use the cash method would continue to be allowed to do so, whether a hybrid method of cash and accrual accounting would apply, or some other standard would be imposed.

President Trump's tax reform plan is not a cash flow plan and takes a more traditional income tax-based approach, yet the principles articulated in the administration's plan are entirely consistent with the continued availability of the cash method of accounting. Growing the economy, simplification, and tax relief are exemplified by the cash method of accounting. Requiring businesses that have operated using the cash method since their inception to suddenly pay tax on money they have not yet collected, and may never collect, is an effective tax increase, and will have a contraction effect on the economy as funds are diverted from investment in the business to pay taxes on money they have not received or as businesses close because of insufficient cash flow and inability to borrow. It is important to note that cash accounting is not a "tax break for special interests;" it is a simple, well-established and long-authorized way of

reporting income and expenses used by hundreds of thousands of family-owned farms, ranches, businesses, and Main Street service providers that are the backbone of any community.

Several recent tax reform proposals, including Senator John Thune's (R-SD) S. 1144, the "Investment in New Ventures and Economic Success Today Act of 2017," would expand the use of cash accounting to allow all businesses under a certain income threshold, including those businesses with inventories, to use cash accounting. Such proposals aim to simplify and reduce recordkeeping burdens and costs for small businesses, while still accurately reporting income and expenses. A few of these proposals (not S. 1144) would pay for this expansion by forcing all other businesses currently using cash accounting to switch to accrual accounting. We do not oppose expanding the allowable use of cash accounting, but it is unfair and inconsistent with the goals of tax reform to pay for good policy with bad policy that has no other justification than raising revenues. When cash accounting makes sense for a particular type of business, the size of the business should make no difference. Further, there have been no allegations that the businesses currently using cash accounting are abusing the method, inaccurately reporting income and expenses, or otherwise taking positions inconsistent with good tax policy.

Tax reform discussions seem to be trending toward faster cost recovery than under current law. For example, the blueprint allows for full expensing of capital investment, Senator Thune's bill makes bonus depreciation permanent, and comments from administration officials suggest that President Trump and his team prefer faster write-offs of capital assets. Such policies benefit capital intensive businesses. However, service businesses by their very nature are not capital intensive, so it would be unfair to allow faster cost recovery for some businesses while imposing an effective tax increase and substantial new administrative burdens on pass-through service providers who will not benefit from more generous expensing or depreciation rules by taking away the use of cash accounting.

Other Implications of Limiting Cash Accounting

In addition to the policy implications, there are many practical reasons why the cash method of accounting is the best method to accurately report income and expenses for farmers, ranchers, and pass-through service providers:

The accrual method would severely impair cash flow. Businesses could be forced into debt to finance their taxes, including accelerated estimated tax payments, on money we may never receive. Many cash businesses operate on small profit margins, so accelerating the recognition of income could be the difference between being liquid and illiquid, and succeeding or failing (with the resulting loss of jobs).

Loss of cash accounting will make it harder for farmers to stay in business. For farmers and ranchers, cash accounting is crucial due to the number and enormity of up-front costs and the uncertainty of crop yields and market prices. A heavy rainfall, early freeze, or sustained drought can devastate an agricultural community. Farmers and ranchers need the predictability, flexibility and simplicity of cash accounting to match income with expenses in order to handle their tax burden that otherwise could fluctuate greatly from

one year to the next. Cash accounting requires no amended returns to even out the fluctuations in annual revenues that are inherent in farming and ranching.

Immutable factors outside the control of businesses make it difficult to determine income.

Many cash businesses have contracts with the government, which is known for long delays in making payments that already stretch their working capital. Billings to insurance companies and government agencies for medical services may be subject to being disputed, discounted, or denied. Service recipients, many of whom are private individuals, may decide to pay only in part or not at all, or force the provider into protracted collection. Structured settlements and alternative fee arrangements can result in substantial delays in collections, sometimes over several years; therefore, taxes owed in the year a matter is resolved could potentially exceed the cash actually collected.

Recordkeeping burdens, including cost, staff time, and complexity, would escalate under accrual accounting. Cash accounting is simple - cash in/cash out. Accrual accounting is much more complex, requiring sophisticated analyses of when the right to collect income or to pay expenses is fixed and determinable, as well as the amounts involved. In order to comply with the more complex rules, businesses currently handling their own books and records may feel they have no other choice than to hire outside help or incur the additional cost of buying sophisticated software.

Accrual accounting could have a social cost. Farmers, ranchers, and service providers routinely donate their products and services to underserved and underprivileged individuals and families. An effective tax increase and increased administrative costs resulting from the use of accrual accounting could impede the ability of these businesses to provide such benefits to those in need in their local communities.

Conclusions

The ability of a business to use cash accounting should not be precluded based on the size of the business or the amount of its gross receipts. Whether large or small, a business can have small profit margins, rely on slow-paying government contracts, generate business through deferred fee structures or be wiped out through the vagaries of the weather. Cash diverted toward interest expense, taxes, and higher recordkeeping costs is capital unavailable for use in the actual business, including paying wages, buying capital assets, or investing in growth.

Proposals to limit the use of cash accounting are counterproductive to the already agreed-upon principles of tax reform, which focus on strengthening our economy, fostering job growth, enhancing U.S. competitiveness, and promoting fairness and simplicity in the tax code. Accrual accounting does not make the system simpler, but more complex. Increasing the debt load of American businesses runs contrary to the goal of moving toward equity financing instead of debt financing and will raise the cost of capital, creating a drag on economic growth and job creation. Putting U.S. businesses in a weaker position will further disadvantage them in comparison to foreign competitors. It is simply unfair to ask the individual owners of pass-through businesses to shoulder the financial burden for tax reform by forcing them to pay taxes on income they have

not yet collected where such changes are likely to leave them in a substantially worse position than when they started.

As discussions on tax reform continue, the undersigned respectfully request that you take our concerns into consideration and not limit our ability to use cash accounting. We would be happy to discuss our concerns in further detail. Please feel free to contact Mary Baker (mary.baker@klgates.com) or any of the signatories for additional information.

Thank you for your consideration of this important matter.

Sincerely,¹

Americans for Tax Reform
 American Council of Engineering Companies
 American Farm Bureau Federation
 American Institute of Certified Public Accountants
 American Medical Association
 The American Institute of Architects
 The National Creditors Bar Association
 Akin Gump Strauss Hauer & Feld LLP
 Baker Donelson
 Debevoise & Plimpton LLP
 Dorsey & Whitney LLP
 Foley & Lardner LLP
 Jackson Walker L.L.P.
 K&L Gates LLP
 Kilpatrick Townsend & Stockton LLP
 Lewis Roca Rothgerber Christie LLP
 Littler Mendelson P.C.
 Miles & Stockbridge P.C.
 Mitchell Silberberg & Knupp LLP
 Morrison & Foerster LLP
 Nelson Mullins Riley & Scarborough LLP
 Ogletree, Deakins, Nash, Smoak & Stewart, P.C.
 Perkins Coie LLP
 Quarles & Brady LLP
 Rubin and Rudman LLP
 Squire Patton Boggs (US) LLP
 Steptoe & Johnson LLP
 White & Case LLP

¹ Although not a signatory to this letter, the American Bar Association (ABA) is working closely with the Coalition and has expressed similar concerns regarding proposals to limit the ability of personal service businesses to use cash accounting. The ABA's most recent letters to the House Ways & Means and Senate Finance Committees are available [here](#) and [here](#).



Insured Retirement Institute
1100 Vermont Avenue, NW | 10th Floor
Washington, DC 20005

t | 202.469.3000
f | 202.469.3030

www.IRIonline.org
www.myIRIonline.org

August 2, 2017

The Honorable Peter Roskam
Chairman, Subcommittee on Tax Policy
Committee on Ways and Means House
2246 Rayburn House Office Building
Washington, DC 20515

The Honorable Lloyd Doggett
Ranking Member, Subcommittee on Tax Policy
House Committee on Ways and Means
2307 Rayburn House Office Building
Washington, DC 20515

**Re: House Committee on Ways and Means, Subcommittee on Tax Policy, July 19, 2017 Hearing:
"How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families"**

Dear Chairman Roskam and Ranking Member Doggett:

The Insured Retirement Institute¹ (IRI) is pleased to submit this letter to you and request that it be entered into the record for the July 19, 2017 hearing on how tax reform can help individuals and families. We are submitting this letter to supplement the previous input IRI provided to you on April 17, 2017² in which IRI detailed our policy proposals about how the tax code should treat retirement savings in tax reform. Our letter today highlights ways that tax reform can help individuals and families across this country who are struggling to meet current financial needs while saving for the secure and dignified retirement they deserve.

¹ IRI is the leading association for the retirement income industry. IRI proudly leads a national consumer coalition of more than 30 organizations and is the only association that represents the entire supply chain of insured retirement strategies. IRI member companies include major insurers, asset managers, and broker-dealers/distributors that account for 95 percent of annuity assets in the United States, with more than 150,000 financial professionals serving over 22.5 million households in communities across the country. As a not-for-profit organization, IRI provides an objective forum for communication and education, and advocates for the sustainable retirement solutions Americans need to help achieve a secure and dignified retirement. IRI is guided in its views by a tax reform task force with active participation by more than 30 of IRI's largest member companies.

² IRI's letter of April 17, 2017 may be accessed through the following link: <http://www.myirionline.org/docs/default-source/press-release/iri-tax-reform-letter-to-house-tax-writers-04-17-2017-final.pdf?sfvrsn=4>

IRI appreciates recent comments made by key administration officials and Speaker Ryan in which they recognized the significant role our nation's tax code plays in helping Americans save for their retirement, and that the current treatment of retirement savings in the code should be protected in tax reform. In briefings on President Trump's tax reform plan, National Economic Council Director Gary Cohn stated: "Homeownership, charitable giving and retirement savings will be protected. But other tax benefits will be eliminated." In a June 20 speech on tax reform, Speaker Ryan made an almost identical statement: "We will clear out special-interest carve outs and expensive deductions, and focus on keeping those that make the most sense: homeownership, charitable giving, and retirement savings."

We also appreciate the July 27, 2017 announcement by the administration and majority House and Senate leaders and tax-writing committee chairs that they anticipate the committees will lead consideration of tax reform this fall. IRI looks forward to continuing to work with you throughout this process.

Preserving the Current Tax Treatment of Retirement Savings is Vital for Retirement Security, Economic Growth and Limiting Demands on Entitlement Programs

The way that retirement savings, including annuities, employer-sponsored retirement plans and individual retirement accounts are treated in the tax code today enables individuals and families to save for their retirement, while simultaneously stimulating U.S. economic growth. IRI urges that the current treatment for retirement savings be maintained in tax reform which will help to allow individuals and families attain a secure and dignified retirement. To further allow individuals and families to enhance their ability to save for their retirement, reforms to the tax code should also include retirement security enhancements and simplify provisions to help individuals and families save more for their retirement.

IRI believes the following facts are helpful to illustrate the vital role of annuities, employer-sponsored retirement plans and individual retirement arrangements (IRAs) and why maintaining the current tax treatment of retirement savings is essential to enabling individuals and families to save for their retirement, while continuing to stimulate economic growth.

- 10,000 Americans will reach retirement age every day through at least 2030, when almost 73 million individuals, or 20 percent of the U.S. population, will be age 65 or older³, and data indicates that many underestimate the financial resources they will need in retirement.⁴

³Insured Retirement Institute Fact Book 2016: *A Guide to Information, Trends, and Data in the Retirement Income Industry*.

⁴See, for example: 1) Society of Actuaries, *2015 Risks and Process of Retirement Survey: Report of Findings*, (January 2016); 2) Society of Actuaries, *Survey Examines Retirement Concerns and Managing Risks*, (June 29, 2016); and 3) Employee Benefit Research Institute, *EBRI Notes: Retirement Income Adequacy for Boomers and Gen-Xers: Evidence from the 2012 EBRI Retirement Security Projection Model*.

- 75 to 85 percent of Baby Boomers, Gen-Xers, individual annuity owners and households with defined contribution plans say current treatment of retirement savings in the tax code are important to their retirement savings.⁵
- Annuities, employer-provided retirement plans and IRAs play a key role in the U.S. economy by producing \$25 trillion of retirement assets (34 percent of all U.S. household assets).⁶ 71 percent of U.S. pension assets are invested in equities and bonds, predominantly from the U.S., which are vital to the economy and its growth.⁷
- 75 million American families rely on annuities and other life insurers' products for peace of mind, long-term saving, and a guarantee of lifetime income and they receive annual benefits of \$179.6 billion. The insurance industry, annuities and other insurers' products generate 2.5 million U.S. jobs, invest \$5.9 trillion (90 percent of industry assets) in our economy and hold 20 percent of all U.S. corporate bonds.⁸

Tax Reform Should Maintain the Diversity of Retirement Plans while Enacting Simplifications

The 2016 House Republican Blueprint (Blueprint) contemplated possible consolidation of "the multiple different retirement savings provisions in the current tax code to provide and effective and efficient incentives for savings and investment." For the reasons set forth below, IRI supports the maintenance of the diverse types and structures of retirement plans, opposes consolidation and calls for the enactment of targeted simplification proposals in tax reform.

⁵Examples include the following: 1) A survey of households with defined contribution plans indicates that tax treatment is "a big incentive to contribute" for 80 percent of households, with 44 percent of households indicating "I probably wouldn't save for retirement if I didn't have a retirement plan at work." *BrightScope and Investment Company Institute, "Americans Views on Defined Contribution Plan Saving, 2016," JCI Research Report (February 2017).*; 2) More than 75 percent of Baby Boomers say that tax deferral is an important incentive – especially for younger and middle-income Boomers. *Insured Retirement Institute, Boomer Expectations for Retirement 2015, Fifth Annual Update on Retirement Preparedness of the Boomer Generation (2015).*; 3) Nearly eight in 10 GenXers (those born between 1965 and 1981) consider tax deferral an important aspect of a retirement investment, and 25 percent of GenXers would be less likely to save for retirement if tax deferral were reduced or eliminated. *Insured Retirement Institute, Don't You (Forget About Means), Third Biennial Study on the Retirement Readiness of Generation X (2016).*; and 4) According to a recent survey of individual annuity owners (80 percent of whom have household incomes under \$100,000), 86 percent said existing tax incentives were an important factor in choosing to purchase their annuity, and 70 percent said they saved more for retirement because of the tax treatment. *The Gallup Organization and Mathew Greenwald & Associates, 2013 Survey of Owners of Individual Annuity Contracts (Conducted for The Committee of Annuity Insurers) (2013)*

⁶Investment Company Institute, *The U.S. Retirement Market*, Third Quarter 2016.

⁷Willis Towers Watson, *Global Pension Assets Study 2017* (January 30, 2017).

⁸American Council of Life Insurers, *2016 Life Insurers Fact Book* (2017). Note: Information about 75 million families derive from ACLI calculations based on U.S. Census, Current Population Survey 2013, and Federal Reserve Board, 2013 Survey of Consumer Finances.

- It is important to retain 401(k), 403(b) and 457(b) defined contribution plans to meet particular needs of employees in private, church, governmental, educational and nonprofit sectors. Diversity, choice and flexible plan design help maximize savings. Employee confusion is not a problem. Each employee simply decides whether to participate in the defined contribution plan his or her employer offers.
- Consolidation (e.g., having just 401(k) plans) is harmful because it takes away important advantages from many employee plan participants and increases complexity, administrative difficulties, and costs. 403(b) and 457(b) plans cover many nonprofit employees, teachers, police, fire and safety workers and can provide helpful features; e.g.: (1) lack of early withdrawal penalty tax; (2) favorable catch-up provisions; and (3) tailored compensation standards and nondiscrimination rules.
- Simplification is helpful because it either broadens the application of helpful provisions or will bring about positive changes for all types of plans. IRI supports targeted simplification proposals which would extend the less strict distribution rules of 401(k) and 403(b) plans to 457(b) plans; direct the Department of Treasury and the Department of Labor to consolidate a series of overlapping notices required to be provided to participants under the rules regarding nondiscrimination safe harbors, automatic enrollment arrangements, fee disclosures and default investments; and modernize and streamline electronic delivery rules and allow sponsors to make electronic delivery the default delivery option for benefit notices.

Tax Reform Should Build on what is Working by Enacting Retirement Security Enhancements

IRI strongly supports consideration of a number of retirement reform proposals that have generated broad bipartisan support and would significantly augment Americans' retirement savings with a very modest impact on revenue. These proposals comprise the core elements of IRI's 2017 Retirement Security Blueprint,⁹ and the first four were included in the *Retirement Enhancement Savings Act of 2016* (S. 3471), which was approved unanimously in September 2016 by the Senate Committee on Finance.¹⁰

- Multiple Employer Plans: Remove regulatory barriers and cost concerns that currently prevent many small and start-up businesses from offering retirement plans by facilitating the use of multiple employer plans and offering lifetime income options within these plans.

⁹ Available at

<https://www.myirionline.org/docs/default-source/advocacy-files/iri-2017-retirement-security-blueprint.pdf?sfvrsn=11>

¹⁰ Approved by Senate Finance Committee on September 21, 2016 on a bipartisan 26-0 vote as part of the *Retirement Enhancement Savings Act of 2016*.

- Annuity Selection Rules: Clarify employer fiduciary responsibility to enable businesses to offer lifetime income options in retirement plans without fear of legal liability.
- Annuity Portability: Enable annuity portability through a technical fix to the tax code and prevent employees who invest in lifetime income options through an employer retirement plan from losing these benefits if their employer changes record-keepers or annuity providers.
- Lifetime Income Estimates: Require lifetime income estimates on workers' benefit statements to encourage workers to save appropriately for retirement by showing the amount of monthly income their nest egg will generate in retirement.
- Automatic Enrollment: Broaden coverage by encouraging employers to auto-enroll workers who currently lack access to employer-provided plans into IRAs, auto-IRAs or other plans by providing employers with tax credits to defray the cost of setting up accounts.
- Default Savings Rates: Better prepare workers for retirement by increasing the default saving rate for participants who are automatically enrolled from three percent to six percent and increasing the limit on automatic escalation of participants' saving rates to 15 percent.

Tax Reform Should Not Significantly Expand the Role of Roth Accounts

At the hearing, Jania Stout of Fiduciary Advisors at HighTower testified on Roth accounts and the possibility of expanding their role. She also addressed several other important retirement savings issues, including:

- The importance of maintaining the current tax treatment of retirement savings;
- How employer-sponsored retirement plans bring retirement savings to the broad base of individuals and families, rather than only to owners and key executives;
- How specific simplification proposals for employer-sponsored retirement plans can help employees and employers alike, while consolidating the diversity of employer defined contribution plans into a single type would be harmful; and
- How legislative retirement security enhancements can reach more individuals and families and significantly increase their retirement savings.

In light of her testimony at the hearing, IRI respectfully reiterates its position that tax reform must maintain the current tax treatment of retirement savings, and not undertake an experiment filled with inherent risk to expand the role of Roth accounts. As Ms. Stout testified she advises employers to include Roth options within their 401(k) plans and noted Roth's appeal for many millennials. However, she cautioned: "Any policy move toward more reliance on Roth contributions must accompany other

changes to the tax incentives to continue to motivate both the employer to sponsor a workplace-based retirement plan and the employee to contribute to it.”

IRI agrees with her assessment about the potential effects of relying more on Roth accounts and does not support any changes in the current tax treatment of retirement savings that would rely more on Roth contributions. The current tax treatment and employer plans provide the immediate help and encouragement for retirement savings which the vast majority of individuals and families desire. IRI research has shown that 75 to 85 percent say current tax treatment is important to them and helps them to save.

By contrast, when required to forego current consumption and conveniences, these individuals and families seem unlikely to be as motivated by the distant benefits offered by Roth accounts. The economic value today of tax-exempt Roth distributions in retirement varies greatly and is difficult to discern. It requires speculation by differently-situated individual taxpayers about their respective tax rates in retirement, often decades into the future.

IRI respectfully submits, the following behavioral evidence to reinforce this assessment:

- After use for 19 years, Roth IRAs hold less than 10 percent of all IRA assets¹¹
- Although more than half of 401(k) plans offer Roth accounts, only about one of five contributing participants make any Roth contributions.¹²

Perhaps the most compelling reason for tax reform to maintain and enhance the current system and not significantly expand the role of Roth is the following:

- Maintaining and enhancing the current system leads business owners and top executives to establish and maintain employer plans that provide retirement savings to the bulk of the nation’s individuals and families because the tax treatment of retirement savings and pension nondiscrimination rules ensure that employer plans provide benefits broadly and do not primarily benefit highly- compensated employees.
- Expanding Roth could provide an alternative for business owners and top executives to utilize Roth accounts for their own benefit, without incurring the costs and restrictions of providing a retirement plan to their employees, resulting to the detriment of a large number of the nation’s individuals and families who might otherwise have had the opportunity to take advantage of a workplace retirement savings plan. This risk is particularly acute for the small business sector which currently experiences the greatest difficulty with meeting the costs and assuming the liabilities associated with employer plans.

¹¹ Investment Company Institute, *2017 ICI Fact Book (2017)*.

¹² Profit Sharing Council of America, *PSCA’s 59th Annual Survey of Profit-Sharing and 401(k) Plans*, (December 19, 2016).

Tax Reform should Maintain Fair Taxes for Life Insurance Companies to Minimize Prices and Maximize Benefits for Annuities and Other Financial Security Products

IRI urges that tax reform maintain fair taxes on life insurance companies in order to minimize prices and maximize benefits for annuities and other insurer products relied on by 75 million American families and to enable the industry to continue serve as a major source of jobs (2.5 million U.S. jobs) and investment capital (invest \$5.9 million into U.S. economy and hold 20 percent of all U.S. corporate bonds).

Specifically, as we discussed in greater detail in our April 17 letter to you, we urge that tax reform:

- Continue to avoid economically harmful 2014 proposals (e.g., reserving, DAC, DRD).
- Apply proposals on expensing of capital expenditures and net interest rules on a fair and consistent basis and repeal harmful restrictions that prevent insurers and their non-life affiliates from filing consolidated returns.

If you have any questions or if we can provide any assistance throughout this important process, please feel free to contact me or any of the following: Lee Covington, IRI's Senior Vice President and General Counsel (lcovington@irionline.org); Paul Richman, IRI's Vice President of Government Affairs (prichman@irionline.org); or Kelli McMorrow, IRI's Vice President of Federal Affairs (kcmcorrow@irionline.org).

Sincerely,



Catherine J. Weatherford
President & CEO
Insured Retirement Institute

Cc: Members of the House Committee on Ways and Means



July 19, 2017

The Honorable Peter Roskam
Chairman
Subcommittee on Tax Policy
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

The Honorable Lloyd Doggett
Ranking Member
Subcommittee on Tax Policy
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Roskam, Ranking Member Doggett, and Members of the Subcommittee,

Thank you for holding a hearing in the House Ways and Means Committee on the topic of “How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families”. The idea we are proposing would raise a significant amount of revenue through federal student loan reforms and help people struggling with student loans get out of student debt faster and start saving for the future. We believe our proposal could raise as much as \$75 billion simply by changing the way the government collects student loan payments from borrowers enrolled in federal Income Driven Repayment programs. It will also help millions of student loan borrowers repay their student loans faster than they otherwise would under current law. This proposal is a win-win for the government and millions of student loan borrowers.

Student Loan IDR Programs Currently Losing Billions of Revenue Per Year

Currently, the federal government is losing billions in revenue from student loan borrowers that are enrolled in federal income driven repayment (IDR) programs. The GAO estimates that all federal student loans (issued between 1995-2017) currently enrolled in IDR programs will cost the government approximately \$74 billion.¹

These well-intentioned IDR programs provide a safety net for lower income borrowers with high monthly student loan payments. IDR programs allow borrowers to cap their monthly payments at a rate equal to a percentage of their discretionary income. Any unpaid principal or

1. ¹ GAO Report to the Chairman, Committee on the Budget, U.S. Senate on November 2016 – “FEDERAL STUDENT LOANS - Education Needs to Improve Its Income Driven Repayment Plan Budget Estimates” – <https://www.gao.gov/assets/690/681064.pdf>

interest payments can be forgiven by the government after consecutive minimum payments of 10 years (Public Service program) or 20 years (income-based and Pay-As-You-Earn programs).

The government is currently losing revenue from federal IDR programs because most if not all of the interest and principal payments will not be collected each month and unpaid principal will be forgiven at the end of the IDR repayment term. Our analysis shows that many borrowers (especially lower income borrowers or high debt-to-income borrowers) make partial or zero interest payments, and therefore both interest and principal is not collected by the government.

Proposal: Bring Private Sector into the Repayment Process and Collect a Higher Percentage of Student Loan Payments

Rather than continue to mount up losses year after year of unpaid interest and principal, the government should encourage employers to participate in the repayment process. Encouraging the private sector to participate in the student loan repayment process effectively shifts the cost of unpaid student loans from the government to the private sector and helps reclaim several billions in principal and interest payments that may have never been collected. Employers would be willing to absorb a portion of the costs associated with offering student loan assistance if an employer tax exclusion is passed into law, especially because it reduces the costs of employee turnover and improves employees' financial health.

Across the income spectrum, especially for borrowers with high student debt levels that are enrolled in IDR programs, the total that the government would be repaid by borrower payments and employer contributions would be much higher than the reduction in taxes. Ideally, we would encourage you to use the revenue generated from this proposal to expand employer student loan assistance to other borrowers with less than \$80,000 in income (or borrowers with high-student debt-to-income ratios) even if they are not enrolled in IDR plans.

Nuts and Bolts of the Proposal

- Provide an annual tax exclusion for employers that offer student loan assistance to employees (up to \$5,000 tax exclusion per employee per year);
- Cap the program for those that need it most – borrowers enrolled in IDR programs, borrowers with less than \$80,000 in annual gross income, or borrowers with high student debt-to-income ratios;
- Do not require low income borrowers to pay more than required under the IDR calculation. The payment would still be a percentage of their discretionary income.
- For example, an employee with AGI of \$20,000 that is enrolled in an IDR plan on a \$20K loan would currently repay the federal government \$4,825 in 20 years (240 months). If the tax law is changed, an employer contribution of \$200 on top of the employee IDR payment would result in a repayment of the full principal and interest of the loan in only 124 months.

- Part of the revenue generated from this proposal should be used to allow employers to provide assistance to borrowers with less than \$80,000 in income even if they are not enrolled in IDR plans.
- This proposal is a win-win-win for the government, American student loan borrowers, and American companies.

We believe the time is ripe to encourage more employers to help their employees repay their loans faster. Please find more information below about how this proposal would save the taxpayer billions per year. I look forward to working with you in more detail to discuss this proposal. If you have any questions about this analysis, please contact me at Cwalters@GradFin.com or (202) 441-1594.

Sincerely,

Chris Walters
CEO
GradFin

Below is more information about the analysis and calculations used to prepare our proposal.

What is the Monthly Student Loan Payment for a Borrower that is Enrolled in the Pay-As-You-Earn IDR Program with a \$20,000 Adjusted Gross Income?

Assuming a 2.4% Wage Growth Per Year, a borrower with an AGI of \$20,000 would be responsible for making a \$15.92 monthly payment in year 1, \$16.30 monthly payment in year 2, \$16.69 monthly payment in year 3, etc.

How is the Monthly IDR Payment Calculated?

The IDR Monthly Payment is based on a calculation that identifies a taxpayer's discretionary income based on the annual poverty level rate according to the HHS Poverty Guidelines.²

- In 2017 the HHS Poverty Guideline is \$12,060 for a taxpayer with no dependents.

² <https://aspe.hhs.gov/poverty-guidelines>

- The Department of Education then calculates 150% of the poverty guideline, which is \$18,090.
- Then, this number is subtracted from the borrower's adjusted gross income (\$20,000 - \$18,090) to come up with the borrower's discretionary income.
- For a taxpayer with no dependents, this would come to \$1,910.
- Then, the discretionary income (\$1,910) is multiplied by 10% to calculate the annual student loan payments.
- This number is \$191.00 for this borrower with no dependents and adjusted gross income of \$20,000.
- Finally, the 10% of discretionary income amount is divided by twelve to calculate the borrower's monthly payment.
- In this case, the borrower would be required to make \$15.92 monthly payments to their student loan.

2017	Income	\$20,000.00
	Income Repayment Program	
	Poverty	\$12,060
	150%	\$18,090
	Discretionary Income	\$1,910.00
	Annual Loan Payments	\$191.00
	Monthly Loan Payments	\$15.92

Under current law, how much can the government expect to be repaid on a \$20,000 student loan (6% interest rate) from a borrower enrolled in the IDR program that makes \$20,000 per year and 2.4% wage growth?

- The most the government would recover over a 20-year period on a \$20,000 loan from a borrower making \$20,000 adjusted gross income (with 2.4% wage growth) is \$4,830.22.
- Even for an outstanding balance of \$5,000, a borrower with \$20,000 AGI that is enrolled in the IDR would not be able to fully pay the interest payments on the loan.
- The interest payments on a \$20,000 loan (6% interest rate) would start at \$100.00.
- Under the IDR repayment plan, the borrower would only be able to make \$15.92 per month, which is not enough to cover the monthly interest payments.
- It is also not enough to even cover the interest payment of a \$5,000 loan, which would start at \$25. At this point, interest capitalization would be a factor for this borrower, making it cost prohibitive for this borrower to ever be able to catch up.

What is Interest capitalization and how does this increase the risk that the government will not get paid on its loan?

- If the borrower's monthly payment is less than the amount of interest that accrues, any unpaid interest is capitalized (added to the principal balance of the loan).
- Interest capitalization increases the risk that the government will not get paid back because under IDR rules, the borrower must repay both the total principal and any capitalized interest if the borrower voluntarily exits the IDR program and because there is no limit on the amount of unpaid interest that may be capitalized.
- At the end of a 20-year IDR repayment period, interest capitalization would mean that the total balance forgiven by the government equals the total unpaid principal and the capitalized interest.
- A \$5,000 loan could grow to \$7,667.16 with interest capitalization and to \$57,073.20 on a \$20,000 loan.
- If the taxpayer is in the 10% tax bracket during this forgiveness event, the taxpayer would owe an additional \$766 in income taxes to the government.

How much can the government expect to be repaid under the following circumstances:

10-Year Standard Repayment Plan (\$5,000 loan)

- Borrower Makes Full Interest and Principal Payments
- The government would expect to make \$6,660 total, or \$666.00 per year from a borrower paying back a \$5,000 loan (6% interest) under the standard 10-year repayment program.

10-Year Standard Repayment Plan (\$20,000 Loan)

- Borrower makes full interest and principal payments.
- The government would expect to make \$26,640 total, or \$2664.00 per year from a borrower paying back a \$20,000 loan (6% interest) under the standard 10-year repayment program.

20-Year IDR Repayment Plan (\$5,000 Loan)

- For a \$20,000 AGI borrower, under the IDR repayment plan, the borrower is only repaying part of the interest payment back to the government.
- Additionally, the borrower is making no payments to their principal balance.
- The government would only collect \$2,130.05 during the first 10 years of the repayment plan.

20-Year IDR Repayment Plan (\$20,000 Loan)

- For a \$20,000 AGI borrower that is enrolled in the IDR repayment plan, paying back a \$20,000 loan would still only result in \$2,130.05.

Difference Between 10-Year Standard and 20-Year IDR Repayment Plans

- On a ten-year federal government budget window, the difference between the amount the government would receive from an IDR borrower is always less than a standard repayment plan borrower.
- For a \$5,000 loan, the difference would be a loss of $\$6,660.00 - \$2,130 = \$4,530$
- For a \$20,000 loan, the difference would be a loss of $\$26,640 - \$2,130 = \$24,510$.

What is the impact of a \$125 or \$200 employer contribution on a \$5,000 or \$15,000 loan for a borrower with \$20,000 adjusted gross income that is also enrolled in the IDR program?

- Adding a \$125 or \$200 employer contribution, in addition to the employee's current IDR payment, would significantly change the repayment forecast for a \$5,000 or \$20,000 loan for an individual that makes \$20,000 in adjusted gross income.

\$5,000 Loan / \$20,000 IDR / \$125 Employer Contribution

- For a \$5,000 loan with a 6% interest rate, if the employee makes their regular IDR payment (starting at \$15.92 per month) and the employer contribution is \$125, the current monthly payment would start at \$140.92.
- The loan would be paid back fully in 40 months, the federal government would get back \$5,655.28.
- The employer would pay approximately \$5,000 and the IDR enrolled employee would pay \$655.28.
- Term is reduced by 200 months (as compared to a regular 20-Year IDR term with no employer contribution).

\$5,000 Loan / \$20,000 IDR / \$200 Employer Contribution

- For a \$5,000 loan with a 6% interest rate, if the employee makes their regular IDR payment (starting at \$15.92 per month) and the employer contribution is \$200, the current monthly payment would start at \$215.92.
- The loan would be paid back fully in 25 months, the federal government would get back \$5,403.33.
- The employer would pay approximately \$5,000 and the IDR enrolled employee would pay \$403.33.
- Term is reduced by 215 months (as compared to a regular 20-Year IDR term with no employer contribution).

\$15,000 Loan / \$20,000 AGI / \$125 Employer Contribution

- Even for a \$15,000 loan, if the adjusted gross income of the employee is only \$20,000, the results are extremely encouraging.
- For a \$15,000 loan with a 6% interest rate, if the employee makes their regular IDR payment (starting at \$15.92 per month) and the employer contribution is \$125, the current monthly payment would be \$140.02.

- The \$15,000 loan would be paid back in 150 months, and the federal government would get back their full loan plus interest equaling \$21,497.04 in 150 months.
- This is also a much better result for the borrower because the borrower would only have to repay their loan for the next 150 months rather than 240 months under a standard IDR plan.
- Additionally, the borrower would not have any money forgiven at the end of the repayment plan, minimizing the personal tax hit that they would take (because any amount forgiven would be taxed).

\$20,000 Loan / \$20,000 AGI / \$200 Employer Contribution

- For a \$20,000 loan with a 6% interest rate, if the employee makes their regular IDR payment (starting at \$15.02 per month) and the employer contribution is \$200 per month, the current monthly payment would be \$215.92.
- The \$20,000 loan would be paid back in 124 months, and the federal government would get back their full loan plus interest equaling \$27,010.72 in 124 months.
- This is a very big result for the borrower, because under a regular IDR repayment program without an employer assistance, the borrower would be making payments for 240 months.
- The \$200 monthly employer contribution cuts that time in half, makes sure the government gets paid back fully (plus interest), and there is no forgiveness tax event for the borrower.
- Plus, the borrower gets a full 10 years of student loan free, which he or she can concentrate their efforts on other personal financial goals, such as purchasing other consumer goods such as an auto or house.

How much total debt would be forgiven for an IDR enrolled borrower that makes AGI \$20,000 and has \$20,000 in student loan debt when they started the IDR program?

- For an IDR enrolled borrower with an income of \$20,000 at the start of the IDR program, and expected wage increase of 2.4% during their career, the IDR enrolled borrower would have to make 240 consecutive payments to the federal government in order to be eligible for forgiveness.
- However, under current law, forgiveness under the 20-year IDR programs are taxable events for the taxpayer, therefore borrowers should expect to pay taxes on any amount that is forgiven after the 20-year IDR period.
- First we need to recognize that for a borrower with an AGI of \$20,000 and an outstanding debt balance of \$20,000, their monthly payments in the IDR program would not be nearly enough to cover the monthly interest payments.
- This is when interest capitalization would set in.
- For example, the monthly payment for an IDR enrolled borrower at \$20,000 AGI would start at \$15.92 per month.

- The interest payment for a \$20,000 loan at 6% would start at \$100. The IDR enrolled borrower would not cover \$84.08 of the interest payment, therefore the loan would appreciate over the course of the life of the loan.
- The balance at the end of the loan period would be \$57,073.20.
- Therefore, as a taxpayer, the borrower would be responsible for \$57,073 in income (because forgiveness is treated as taxable income even though it is not recognized income).
- If the borrower is in the 10% tax bracket, the borrower would owe approximately \$5,700 in taxes.

What is the federal government's return on investment by reducing taxes to encourage employers to make an employer contribution?

Across the income spectrum, especially for borrowers with high student debt levels that are enrolled in IDR programs, the total that the government would be repaid by borrower payments and employer contributions would be much higher than the reduction in taxes.

- If the government reduces taxes on an employer to encourage monthly employer contributions, the government would be in a more favorable position to return more of the principal and interest, especially if a borrower is enrolled in an IDR program because their federal loans are in excess of their monthly obligation.
- In this case, the government would lose 7.65% for the payroll tax and an additional tax on the employees share of the total contribution.
- For example, a \$125 contribution would cost the government \$9.56 plus approximately \$10, because this taxpayer would likely be in the 10% tax bracket.
- In this case the tax would be \$19.56 per \$125 spent by the employer on student loan assistance that the government would not be collecting because the payment would be tax free.
- For a \$125 contribution, the \$20,000 income borrower enrolled in the IDR program would cost the government approximately \$234.72 per year in tax revenue and \$2,347.20 over ten years.
- However, the government would expect to return the full principal and interest of the loan in 40 months (Appendix 4) with the \$125 monthly employer contribution, therefore the tax reduction on the employer contribution would only be $(40 \times \$19.56) = \782.40 .

What is the present value to the federal government of the loans in standard repayment vs. IBR? What is the present value with a \$125/mo employer contribution?

The present value of a \$5,000 loan for a borrower that makes \$20,000 per year in:

- IDR plan is \$2,544
- IDR plan with a \$125/mo employer contribution is \$5,534
- Standard repayment is \$6,005
- Standard repayment with a \$125/mo employer contribution is \$5,341

The present value of a \$20,000 loan for a borrower that makes \$20,000 per year in:

- IDR plan is \$6,627
- IDR plan with a \$125/mo employer contribution is \$16,923
- Standard repayment is \$24,020
- Standard repayment with a \$125/mo employer contribution is \$23,138

What is the Simplest Example of How this Proposal Could Save the Government Revenue?

For example, a borrower is projected to have \$50K in loans forgiven in 20 years as part of the government's Income Driven Repayment ("IDR") forgiveness program, and has a 10% tax rate. The borrower's employer is willing to contribute \$100 per month if the contribution is given favorable tax treatment from the government. The following table demonstrates the government and employees / borrowers are better off when the cost of student debt is shifted to employers.

<i>(in \$'000s)</i>	Employee projected to have \$50K in loans forgiven in 20 years	Under proposed student loan contribution tax incentive	Impact to each party
Government	-\$50.0	-\$26.0	+\$24.0
Employee / borrower	-\$5.0	-\$2.6	+\$2.4
Employer	-	-\$24.0	-\$24.0

Employers are willing to absorb a portion of the costs of student debt for their employees in an effort to reduce costs associated with employee turnover, increasing job tenure and improving their employees' financial health. Employers also believe this will result in a more productive employee base.

How much Could this Proposal Potentially Save the Government?

As of September 2016, there were **5.3** million borrowers enrolled in the IDR plans, with **\$269B** in total loan principal². This implies that the average loan size for these borrowers is \$50,755. These numbers could increase to **11.1** million borrowers and **\$563B** if all borrowers who are eligible for IDR plans enroll³.

The average loan amount expected to be forgiven for these borrowers is summarized in the table below (assuming a 6% interest rate on the loans). As a result, the total estimated forgiveness cost from the IDR plans could range between **\$327B** and **\$686B** in 10 years and will likely be considerably greater when the loans from the IDR plans are actually forgiven in 20 years.

<i>Earnings Range</i>	# of Borrowers (in mm)		Avg. Forgiven Amount on a Loan w/ \$50K Balance Today (est., in \$)	Total Forgiven Amount (est., in \$B)	
	Current	Potential		Current	Potential
<\$20K	4.4	9.2	\$66,067	\$291B	\$608B
\$20-\$40K	0.6	1.3	\$53,317	\$32B	\$69B
\$40-\$80K	0.2	0.4	\$21,803	\$4B	\$9B

\$80K+	0.1	0.2	-	-	-
Total	5.3	11.1		\$327B	\$686B

If employers are incentivized to contribute to their employees' loans the losses from the IDR plans could be greatly reduced. All parties will benefit from the program, including the employees / borrowers, the government and employers. The tables below demonstrate how a tax-free employer contribution could benefit each party.

<i>CURRENT IDR ENROLLEES (5.3mm)</i>	Costs Without Tax-Free Employer Contributions		Costs With Tax-Free Employer Contributions (\$200/mo for 10yrs)			Benefits	
	<i>Earnings Range</i>						
	Gov't	Borrowers	Gov't	Borrowers	Employers	Gov't	Borrowers
<\$20K	-\$291B	-\$36B	-\$227B	-\$28B	-\$63B	+\$64B	+\$8B
\$20-\$40K	-\$32B	-\$5B	-\$23B	-\$4B	-\$9B	+\$9B	+\$1B
\$40-\$80K	-\$4B	-\$1B	-\$2B	-\$0.3B	-\$3B	+\$2B	+\$0.7B
\$80K+	-	-	-	-	-	-	-
Total	-\$327B	-\$42B	-\$252B	-\$32B	-\$75B	+\$75B	+\$10B

Note: This assumes borrower tax rates are based on income and are 12.5%, 15%, 20%, respectively. Also, this assumes that 60% of employers offer this benefit which is consistent with 401K adoption.

<i>POTENTIAL IDR ENROLLEES (11.1mm)</i>	Costs Without Tax-Free Employer Contributions		Costs With Tax-Free Employer Contributions (\$200/mo for 10yrs)			Benefits	
	<i>Earnings Range</i>						
	Gov't	Borrowers	Gov't	Borrowers	Employers	Gov't	Borrowers
<\$20K	\$608B	-\$76B	-\$475B	-\$59B	-\$132B	+\$132B	+\$17B
\$20-\$40K	\$69B	-\$10B	-\$51B	-\$8B	-\$19B	+\$19B	+\$2B
\$40-\$80K	\$9B	-\$2B	-\$3B	-\$1B	-\$5B	+\$5B	+\$1B
\$80K+	-	-	-	-	-	-	-
Total	\$686B	-\$88B	-\$529B	-\$68B	-\$156B	+\$156B	+\$20B



AMERICAN CITIZENS ABROAD
EDUCATE, ADVOCATE AND INFORM



**Committee on Ways and Means
U.S. House of Representatives**

**Hearing on
How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families**

Wednesday, July 19, 2017

**Submission of
American Citizens Abroad, Inc. and
American Citizens Abroad Global Foundation**

This Submission is made by American Citizens Abroad, Inc. and American Citizens Abroad Global Foundation. We appreciate the opportunity to contribute to the record of this Hearing.

American Citizens Abroad, Inc. and American Citizens Abroad Global Foundation represent the interests of Americans abroad. We are nonprofit, nonpartisan, volunteer, membership organizations. American Citizens Abroad, Inc. is qualified as a tax-exempt social welfare organization. Incorporated in 2012, it is the successor of American Citizens Abroad, which was organized as a voluntary association by American expatriates principally in and around Geneva in 1978. American Citizens Abroad Global Foundation (ACAGF) is a publicly-supported charity.

This Submission was prepared by Marylouise Serrato, Executive Director, Jonathan Lachowitz, Chairman, ACA, Charles M. Bruce, Legal Counsel of ACA and Chairman of American Citizens Abroad Global Foundation, and Glen Frost, Assistant Legal Counsel, ACA. Mr. Lachowitz is Founder, White Lighthouse Investment Management-Boston and Lausanne. Mr. Bruce is Of Counsel, Bonnard Lawson-Lausanne. Mr. Frost is Partner, Frost & Associates-Washington, DC. All members of ACA's Executive Committee and retired Director Jackie Bugnion contributed. For additional information, contact info@americansabroad.org. The views expressed herein represent those of ACA and not of any particular member of either organization.

Background

With respect to the enactment of residency-based tax rules, over the last three years, ACA and ACAGF (herein "ACA") have done first the spadework and then the detailed analysis necessary to foster this change. This started with a Forum on "Taxation of Americans Abroad in the 21st Century: Citizenship-Based Taxation vs. Residency-Based Taxation", held at the University of Toronto in May 2014. Beginning in early 2015 and steadily since then, ACA has dug into the details. It developed a so-called "middle-of-the-road" or "baseline" approach setting forth the issues in the form of a side-by-side comparison of current law with possible changes. This was not a legislative proposal, as such, but rather a listing of issues, which was intended to encourage

WASHINGTON HEADQUARTERS
11140 ROCKVILLE PIKE, SUITE 100-102
ROCKVILLE, MARYLAND 20852

PHONE: +1 540 628-2426
EMAIL: info@americansabroad.org
WEBSITE: WWW.AMERICANSABROAD.ORG



AMERICAN CITIZENS ABROAD
EDUCATE, ADVOCATE AND INFORM



careful consideration of all the points, large and small. It was also intended to be a basis for revenue estimates. ACA produced a detailed description of the approach. It developed and has revised several times Frequently Asked Questions on the subject. It has conducted several briefings for professionals. Also, it has liaised with other interested groups. Documents and descriptions relating to this activity appear on ACA's website at <https://www.americansabroad.org>. Starting several months ago, utilizing a novel crowd-funding approach, ACA began raising funds to support the scoring of residency-based taxation. <http://www.acaglobalfoundation.org/donate>.

ACA Urges Congress to Amend the Internal Revenue Code to Switch from Citizenship-Based Taxation to Residency-Based Taxation

ACA urges Congress to reform the Internal Revenue Code. It should do so as soon as possible. In the area of international tax provisions, at the same time it modernizes the rules applicable to U.S. corporations with foreign earnings and foreign subsidiaries and other operations, among other things adopting "territorial" tax principles, similarly it should apply "territorial" tax principles broadly to individuals.

Doing so will help the millions of Americans living outside the United States. It will help small businesses in the US who want to hire or contract with Americans abroad to help them promote and expand their businesses. Small businesses cannot afford to incur the costs associated with hiring and retaining Americans abroad.

"Territoriality" for corporations, as this Committee knows well, means that U.S. corporations, which are currently taxed, in general, on their worldwide income regardless where the income is earned, would be taxed only on income earned in the U.S. Under current rules, corporations benefit from partial territoriality in the sense that foreign subsidiaries organized and operated in highly circumscribed ways can defer U.S. tax. As for individuals, at present, they are taxed on their worldwide income regardless where they reside. Taxpayers meeting stringent residency-abroad tests, that is, they truly reside outside the U.S. and do so not just for short periods of time, are entitled to a form of partial territoriality in that they can exclude a portion of their foreign earned income, but not other types of income, and perhaps deduct some foreign housing costs.

Territorial tax treatment of individuals equates to taxation on a residency basis, according to where you reside, as opposed to taxation on a citizenship basis, that is, due solely to the fact that you are U.S. citizen.

Congress should amend the tax rules applicable to individuals residing abroad, making them taxable only on U.S. source income and income connected with the U.S. business or otherwise



AMERICAN CITIZENS ABROAD
EDUCATE, ADVOCATE AND INFORM



connected with the U.S. These rules would only apply to Americans truly residing abroad, not to Americans residing in the U.S.¹

There are an estimated 9 million Americans living overseas. Many have lived there all their lives. They may have moved abroad after meeting their foreign spouse or partner or attending school or finding a job. They may have been born to non-U.S. citizens only temporarily in the U.S., for example, studying—well obviously not just studying—at a U.S. university. Based on 2014 census figures, if grouped like a state, Americans abroad would be the 11th largest state, just ahead of New Jersey and Virginia. Due to voting rules, however, they do not vote as a block. Rather their votes are mostly disbursed among the 50 states where they last lived or where their parents last lived.

American citizens, since the Civil War and without interruption since 1913, like corporations, have been taxed on their worldwide income, regardless where they reside or where the income arises. This rule was initially intended to catch individuals who dodged the draft or otherwise shirked their duties to the Union. Since 1926, however, a version of partial “territoriality” for individuals has permitted Americans residing abroad to not pay tax on limited amounts of foreign earned income and foreign housing costs. These rules are tortured and have been amended many times—17 times just since 1962.

As things stand, the U.S. is wildly out of sync with the rest of the world in the way it taxes individuals residing outside the country. It is the only country other than war-torn and impoverished Eritrea that taxes individuals based on their citizenship. An American citizen who, for example, has resided outside the U.S. all her life, who owns no property in the U.S. and who earns no U.S. source income, is required to file returns and pay U.S. taxes the same as someone living in St. Louis. The fact that she also pays tax to the country where she resides makes no difference. And because the U.S. does not have tax treaties with most countries, and many existing tax treaties are outdated, the goal of avoiding double taxation of income is often not completely achieved. A clear example is the 3.8% Net Investment Income Tax, enacted in combination with the Affordable Care Act 2010, which cannot be offset by foreign tax credits; thus, income can be taxed once by the foreign country where the individual resides in a second time by the U.S.

The tax rules and forms confronting the American citizen living overseas are mind-boggling, and the penalties for incorrect reporting or, more likely, simply not understanding the rules, can be financially ruinous. It's very difficult for taxpayers to prepare their own tax return. The forms for claiming exclusions and foreign tax credits and to report foreign financial assets are extremely challenging. A typical tax return for a relatively simple financial situation can easily run 75 to 100 pages and much more for self-employed individuals and small business owners.

¹ Americans residing in the U.S. who are shareholders in foreign corporations may benefit from changes in the rules for taxing these and similar foreign entities.



AMERICAN CITIZENS ABROAD
EDUCATE, ADVOCATE AND INFORM



Only around 450,000 taxpayers, based on most recent figures, claimed the foreign earned income exclusion, which is the tax provision designed to help them. Many more, close to 4 million, claimed foreign tax credits. It is estimated, based on projections for 2018, that the exclusion, in saved taxes, was worth about \$7 billion. Savings due to the foreign tax credit are generally not viewed as a tax expenditure because the credit is simply a way of avoiding patently unfair double taxation.

Now's the Time to Correct This Indefensible Incongruity

With the concept of “territoriality” on the table with respect to corporate tax law changes, the concept and its workings are on everyone’s mind. A change for individuals can be made easily, without major surgery on the Internal Revenue Code. Simply put, Americans abroad would be treated essentially the same as foreign individuals. It follows, they would remain taxable on U.S.-source income. This is the same approach used by all other developed countries. Moreover, it might be achieved without a loss of tax revenue. Loopholes can be guarded against with super strict drafting.

Problems associated with FATCA that today plague Americans abroad, such as the problem of “lockout” foreign financial institutions, would largely go away. An American citizen residing abroad would no longer be treated as a US account holder for FATCA purposes. Foreign banks would no longer need to be wary of providing services to this individual. Also, the problems of enforcing tax and foreign account reporting rules against Americans overseas could be reassessed. These individuals would be incentivized to bring themselves into compliance. There would no longer be the need to chase after them and employ complicated and sometimes unfair disclosure and other enforcement programs.

The amount of tax revenue involved, by any estimate, is minimal—less than the cost of running the Federal government for one day. With thoughtful choices about the design of the new rules and transition provisions, the cost might be reduced to nil. In fact, taking into consideration reasonable assumptions concerning improved compliance and without “cooking the books”, the overall revenue effect might be slightly positive.

Residency-based taxation would encourage many taxpayers outside the US, who are currently not compliant for a myriad of reasons, to bring themselves back into the voluntary compliance system. This would lead to a pickup of revenues immediately following enactment and an ongoing stream of increased tax collections in the future.

Residency-based taxation would translate into more jobs for Americans and more exports of American goods and services around the world. As it stands, the tax code encourages U.S. businesses to expand and earn profits globally, but to do so without hiring U.S. citizens, who due to citizenship-based taxation can cost 2 to 3 times the amount of hiring a non-American. Congress should act strategically to encourage more Americans to live and work overseas. An

WASHINGTON HEADQUARTERS
11140 ROCKVILLE PIKE, SUITE 100-162
ROCKVILLE, MARYLAND 20852

PHONE: +1 540 628-2426
EMAIL: INFO@AMERICANSABROAD.ORG
WEBSITE: WWW.AMERICANSABROAD.ORG



AMERICAN CITIZENS ABROAD
EDUCATE, ADVOCATE AND INFORM



enormous ambassadorial force would be created, which would encourage the purchase of American goods and services.

Small businesses would no longer face the problem of hiring Americans to work and market their products abroad. Larger exporters would save the costs of employing Americans abroad and having to incur the costs of equalizing their after-tax compensation and paying for the accounting and return preparation costs associated with this.

Where Does Enactment of Residency-Based Taxation Fit in The Landscape of Tax Reform?

There is a wide range of plans for reforming corporate taxes, but all of them include some form of “territoriality”. House Republicans have developed a “blueprint” for tax reform that adopts a territorial approach for corporations and quite deliberately presents the possibility of changes for individuals. On the Senate side, Chairman Hatch’s 2014 corporate integration proposal called for reconsideration of the taxation of nonresident citizens. Treasury Department and the White House, in the recently proposed 2018 budget, expressed interest in transitioning to a territorial system.

Individual members, such as Representative Holding up this Committee, have made a point of supporting elimination of citizenship-based taxation. Again, this is another way of stating “territoriality” for individuals.

Residency-based taxation for American citizens residing abroad fits comfortably alongside all the international tax reform proposals being developed, and importantly it can attract bipartisan support at a time when many would like to see more of this sort of thing. While differing on some details, Democrats Abroad, Republicans Overseas, Americans for Tax Reform, the Heritage Foundation, American Citizens Abroad, a number of American Chambers of Commerce overseas, and other business groups, all support changing from citizenship-based taxation to a residency-based taxation approach.

Well-crafted legislation will benefit individual Americans. It will benefit small business. It will result in increased employment of Americans, decreased costs to the government, simplification of the tax code, and a re-invigorated American diaspora to promote America’s goods and services around the world.

ACA SUBMITS THE TIME IS NOW FOR THE CONGRESS TO ENACT RESIDENCY-BASED TAXATION FOR AMERICANS ABROAD. PROVISIONS TO THIS EFFECT, WE RESPECTFULLY REQUEST, SHOULD BE MADE A PART OF THE TAX REFORM PACKAGE BEING DEVELOPED.

WASHINGTON HEADQUARTERS
11140 ROCKVILLE PIKE, SUITE 100-102
ROCKVILLE, MARYLAND 20852

PHONE: +1 540 628-2426
EMAIL: INFO@AMERICANSABROAD.ORG
WEBSITE: WWW.AMERICANSABROAD.ORG



How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families

**Statement for the Record
Submitted to the Committee on Ways and Means
U.S. House of Representatives
May 18, 2017**

The National Low Income Housing Coalition (NLIHC) urges Congress and the Trump administration to use tax reform as an opportunity to help address one of the most critical issues facing extremely low-income families today: the lack of decent, accessible, and affordable housing. Through smart, modest reforms to the mortgage interest deduction (MID) – a \$70 billion tax write-off that primarily benefits higher income households – Congress can reprioritize and rebalance federal spending on housing to help make the deeply targeted investments in affordable rental housing that our nation needs to help the economy, our communities, and families thrive. *All without increasing costs for the federal government.*

NLIHC is dedicated solely to ensuring that people with the lowest incomes in the United States have affordable and decent homes. Our members include state and local housing coalitions, nonprofit housing providers, homeless service providers, fair housing organizations, researchers, public housing agencies, private developers and property owners, local and state government agencies, faith-based organizations, residents of public and assisted housing, and concerned citizens. While our members include the spectrum of housing interests, we do not represent any segment of the housing industry. Rather, we work with and on behalf of extremely low income households who receive or need housing assistance.

Research confirms that access to an affordable rental home is essential to economic prosperity and job creation. Having an affordable place to call home allows families to participate fully in the economy, making it easier for adults to find and keep good jobs and contribute to economic growth. An affordable home improves children's health and education in ways that increase their chances of economic success as adults. Federal investment in affordable housing boosts local economies and creates jobs. Despite the benefits of affordable housing, three out of four families eligible for rental assistance go without this help.

NLIHC and our [United for Homes](#) campaign proposes modest reforms to the MID to provide 25 million low and moderate income homeowners with a greater tax break and to reinvest the \$241 billion in savings over 10 years to provide affordable rental homes to families with the greatest needs. With these reforms, Congress and the Trump administration can help end homelessness and housing poverty once and for all, giving

all families an opportunity to break through the cycle of poverty and climb the ladder of economic success.

I. The Need for Affordable Housing

Today, the affordable housing crisis in America continues to reach new heights. Rents are rising, wages of the lowest income workers are flat, and more people are renting their homes than ever before. But the supply of affordable housing and rental assistance has not kept pace. As a result, record-breaking numbers of families cannot afford a decent place to call home.¹ Every state and congressional district is impacted. Unless we increase investments in affordable housing to keep up with the need, these challenges will only get worse as demand for rental housing grows over the next decade.²

The greatest need for affordable housing—on the local, state, and national level—is concentrated among extremely low income renters who earn no more than 30% of the area median income (AMI) or the poverty guideline. NLIHC's recent report, [The Gap: The Affordable Housing Gap Analysis 2017](#), found that there is a shortage of 7.4 million affordable and available rental homes for the nation's 11.4 million extremely low income renters. Nationally, only 35 affordable homes are available for every 100 extremely low income renter households. As a result, 71% of the poorest families are severely cost-burdened, spending more than half of their limited income on rent and utilities. These 8.1 million households account for 72.6% of all severely cost burdened renters in the country. They are forced to make difficult choices between paying rent and buying groceries or visiting their doctor. This is the definition of "housing poverty." In the worst cases, these families become homeless.

NLIHC's 2016 [Out of Reach](#) report shows the difference between wages and the price of housing in every state, county, and jurisdiction by estimating each locality's "housing wage," the hourly wage a full-time worker needs to earn in order to afford a modest, two-bedroom apartment. In 2016, the national housing wage was \$20.30 per hour. A worker earning the federal minimum wage would need to work 112 hours a week—or 2.8 full-time jobs—just to afford a modest two-bedroom apartment. While the housing wage changes from state to state and county to county, there is no jurisdiction in the United States where a full-time worker earning the prevailing minimum wage can afford a modest, two-bedroom apartment. And it's not just minimum wage workers for whom rents are out of reach: the average renter in the U.S. earns \$15 per hour - \$5 an hour less than the national housing wage. NLIHC's 2017 edition of this report will be published on June 8.

¹ According to HUD programs, households spending more than 30% of income for these housing costs are considered to be "cost-burdened." Households spending more than 50% are considered to be "severely cost-burdened."

² https://www.washingtonpost.com/news/in-theory/wp/2016/10/11/better-housing-policy-could-save-us-all-money-why-are-we-ignoring-it/?utm_term=.7baa41ec3cb9

The public is looking to the White House and Congress for solutions. According to a recent How Housing Matters survey, 81% of Americans believe housing affordability is a problem in America, and 60% characterize affordability as a serious problem. Three out of four (76%) Americans believe it is important for federal elected officials to take action on housing affordability, and 63% believe the issue is not getting enough attention.³

1. Impact on Economic Mobility

Affordable housing is a long-term asset that helps families and children climb the economic ladder. According to the How Housing Matters survey, 70% of Americans agree that “investing in affordable, quality housing is investing in kids and their future.”⁴

Increasing the supply of affordable housing and rental assistance—especially in areas connected to good schools, well-paying jobs, healthcare, and transportation—helps families climb the economic ladder and leads to greater economic and community development. In addition, children who live in a stable, affordable home have better health and educational outcomes, gain greater access to economic opportunities, enjoy better mental and physical well-being, and benefit from stronger communities. Research shows that increasing access to affordable housing is *the most cost-effective strategy* for reducing childhood poverty in the United States.⁵

Groundbreaking research by economist Raj Chetty offers persuasive evidence of the impact of affordable housing on upward mobility for children. Using new tax data, Chetty and his colleagues assessed the long-term outcomes for children who moved at a younger age to lower poverty neighborhoods. Chetty’s study found that children who were younger than 13 when their family moved to lower poverty neighborhoods saw their earnings as adults increase by approximately 31%, were more likely to live in better neighborhoods as adults, and less likely to become a single parent.

Other research shows that children living in stable, affordable homes are more likely to thrive in school and have greater opportunities to learn inside and outside the classroom. Children in low income households that live in affordable housing score better on cognitive development tests than those in households with unaffordable rents.⁶ Researchers suggest that that is partly because parents with affordable housing can invest more in activities and materials that support their children’s development.⁷

Having access to affordable housing allows the lowest income families to devote more of their limited resources to other basic needs. Families paying large shares of their

³ <http://howhousingmatters.org/articles/affordable-housing-investment-kids-future/>

⁴ <http://howhousingmatters.org/articles/affordable-housing-investment-kids-future/>

⁵ <http://www.urban.org/research/publication/reducing-child-poverty-us>

⁶ <http://www.tandfonline.com/doi/abs/10.1080/10511482.2014.899261>

⁷ https://www.macfound.org/media/files/Affordable_Housing_Child_Enrichment_Stronger_Cognitive_Development.pdf

income for rent have less money to spend on food, health care, and other necessities than those with affordable rents.⁸

2. Impact on the Economy and Job Creation

Beyond the broad benefits to economic mobility, an investment in affordable housing for the lowest-income households bolsters productivity and economic growth. By connecting workers to communities with well-paying jobs, good schools, and transit, investments in affordable housing can spur local job creation and increase incomes. Investments in affordable housing also boosts local economies and contributes to neighborhood and community development.

Research shows that the shortage of affordable housing in major metropolitan areas costs the American economy about \$2 trillion a year in lower wages and productivity. Without affordable housing, families have constrained opportunities to increase earnings, causing slower GDP growth. Moreover, each dollar invested in affordable housing boosts local economies by leveraging public and private resources to generate income—including resident earnings and additional local tax revenue—and support job creation and retention. Building 100 affordable rental homes generates \$11.7 million in local income, \$2.2 million in taxes and other revenue for local governments, and 161 local jobs in the first year.⁹

II. The Need to Reform the Mortgage Interest Deduction

Congress has a clear opportunity to enact tax reform that addresses the growing affordable rental housing crisis facing millions of low-income people in every state and community. That starts with reforming the mortgage interest deduction (MID), our nation's largest housing subsidy, and reinvesting these scarce resources to serve those with the greatest needs.

MID reform is no longer a political “third rail.” Experts from across the ideological spectrum are increasingly calling the MID what it really is: a wasteful use of federal resources that encourages households to take on higher levels of debt, disrupts the housing market by increasing costs for everyone, and mostly benefits those who do not need federal assistance to live in a stable home. This includes the [Wall Street Journal](#) editorial board, former President George W. Bush advisor Dennis Shea, the CATO Institute, the Ronald J. Terwilliger Foundation, former President Obama advisor Michael Stegman, former Labor Secretary Robert Reich, Pulitzer prize-winning author and sociologist Matthew Desmond, and many others.

Each year, the federal government spends almost \$200 billion to help Americans buy and rent their homes. A full 75% of all federal housing resources goes to subsidize higher income homeowners through the MID and other homeownership tax breaks. In fact, the federal government spends more to subsidize the homes of the 7 million

⁸ http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/americas_rental_housing_2015_web.pdf

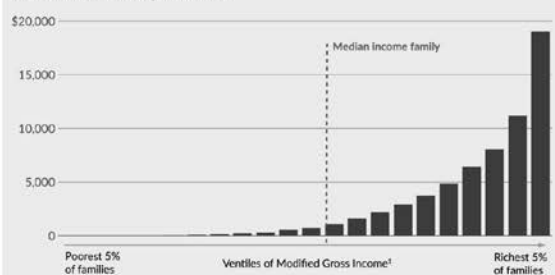
⁹ https://www.nahb.org/~media/Sites/NAHB/Economic%20studies/1-REPORT_local_20150318115955.ashx?la=en

households with incomes above \$200,000 than to help the 55 million households with incomes of \$50,000 or less, even those these families are more likely to struggle to afford a place to call home.

The MID is poorly targeted and largely benefits America's highest income households. According to the Congressional Budget Office, 75% of the benefits of the MID go to the top 20% of earners; 15% of the benefits to the top 1%. Almost all of the tax break goes to households with incomes above \$100,000.

Deductions for homeowners rise with income

The Home Mortgage Interest Deduction received by families divided into 20 groups (ventiles) by modified gross income



Washington Center for Equitable Growth

Everyone else gets almost nothing. Half of all homeowners receive no tax benefit from the MID because they do not itemize their tax deductions and instead take the standard deduction. At the same time, only one in four of the poorest households that are eligible for housing assistance get the help they need because of chronic underfunding.

Economists across the political spectrum agree that the MID does little to promote homeownership. Higher income households that do benefit from the MID would likely choose to buy a home regardless of whether they receive a tax break. Similar countries without a MID have the same homeownership rate as the U.S. or higher.

Moreover, the MID primarily benefits affluent homeowners living in expensive urban areas in just a handful of states. More than 40% of MID dollars claimed go five states, skewed to the higher income homeowners. The rest is divvied up between the remaining 45 states.

III. The United for Homes Proposal

NLIHC's United for Homes campaign – which has been endorsed by more than 2,300 organizations, local governments, and elected officials – proposes to reform the MID. The changes are simple and modest.

UFH calls for reducing the size of a mortgage eligible for the MID from \$1 million to the first \$500,000, generating \$87 billion in savings over 10 years. An analysis of 2013-2015 Home Mortgage Disclosure Data (HMDA) shows that just 6% of all

mortgages in the U.S. are over \$500,000. Moreover, homeowners with large mortgages would still receive tax relief on the first \$500,000 of their mortgage.



1. National Housing Trust Fund

The national Housing Trust Fund is the first new housing resource in a generation. It is exclusively targeted to help build, preserve, and rehabilitate housing for people with the lowest incomes.

NLIHC led a national coalition that played a critical role in the creation of the Housing Trust Fund through the passage of the *Housing and Economic Recovery Act of 2008*. In 2016, the first \$174 million in Housing Trust Fund dollars were allocated to states. This is an important step, but far more resources are necessary to meet the need.

The Housing Trust Fund is the *only federal housing program* exclusively focused on providing states with resources targeted to serve households with the clearest, most acute housing needs. Because the Housing Trust Fund is administered by HUD as a block grant, each state has the flexibility to decide how to best use Housing Trust Fund resources to address its most pressing housing needs. Each state distributes the resources based on its annual Allocation Plan, which identifies the state's priority housing needs. States decide which housing developments to support.

The Housing Trust Fund is also *the most targeted federal rental housing production and homeownership program*. By law, at least 75% of Housing Trust Fund dollars used to support rental housing must serve extremely low income (ELI) households earning no more than 30% of the Area Median Income (AMI) or the federal poverty limit. All Housing Trust Fund dollars must benefit households with very low incomes earning no more than 50% of AMI. In comparison, most other federal housing programs can serve families up to 80% of AMI. The statute requires that at least 90% of the funds be used for the production, preservation, rehabilitation, or operation of rental housing. Up to 10% may be used for homeownership activities for first-time homebuyers: production, preservation, and rehabilitation; down payment, closing cost, and interest rate buy-down assistance.

Currently, the Housing Trust Fund is funded with dedicated sources of revenue outside of the appropriations process. The initial source of funding designated in the statute is an annual assessment of 4.2 basis points (0.042%) of the volume of business of Freddie Mac and Fannie Mae, 65% of which goes to the Housing Trust Fund.

The statute also provides that the Housing Trust Fund can be funded by other sources of revenue, such as any appropriations, transfers, or credits that Congress may designate in the future. However, the Housing Trust Fund should be funded with dedicated revenues generated outside of the appropriations process so that it does not compete with existing HUD programs.

2. Renters' Credit

NLIHC supports proposals to establish a tax credit to help make housing affordable for renters with the lowest incomes.¹⁰ Our nation has long provided mortgage tax relief for higher income homeowners, most of whom would be stably housed without assistance. A renters' tax credit that could help ensure that the lowest income households can afford a safe, decent home is long overdue.

A renters' tax credit could complement the existing Low Income Housing Tax Credit—which works well as a subsidy for affordable housing development, but is rarely sufficient on its own to push rents down to levels poor families can pay—and rental assistance programs, such as Housing Choice Vouchers—which are highly effective, but reach only a modest share of the families in need of such assistance.

Any renters' credit should be tailored to benefit primarily families with the lowest incomes. Efforts to ensure that extremely low income households do not pay more than 30% of their incomes on housing should be prioritized.

Proposals to establish a renters' tax credit offer a promising opportunity to address the affordable housing challenges of the many lowest income households who go without assistance and to help these families keep more of their incomes for other necessities.

3. Housing Choice Vouchers

Housing Choice Vouchers are a proven tool in reducing homelessness and housing insecurity, as well as helping families climb the economic ladder. Housing vouchers help people with the lowest incomes afford housing in the private housing market by paying landlords the difference between what a household can afford to pay in rent and the rent itself, up to a reasonable amount. Administered by HUD, housing vouchers comprise the agency's largest rental assistance program, assisting more than 2.2 million households.

Despite the program's proven success in ending homelessness and reducing housing insecurity, limited funding means that a very low share of eligible families receives this needed assistance. Today, just one in four eligible families receive the rental assistance they need.

Recently, NLIHC published *Housing Spotlight: The Long Wait for a Home*, which examined the waiting lists for federally assisted housing. NLIHC surveyed public housing authorities (PHAs) across the nation and found that more than half (53%) of all waiting lists for Housing Choice Vouchers (HCVs) were closed to new applicants. Of these, 65% had been closed for at least one year. The average wait time for vouchers is

¹⁰ Proposals have been developed by the Center on Budget and Policy Priorities (CBPP) and the Turner Center for Housing Innovation at the University of California Berkeley. Details on the CBPP proposal can be found here: <http://www.cbpp.org/research/housing/renters-tax-credit-would-promote-equity-and-advance-balanced-housing-policy>. The Turner Center proposal can be found here: <http://turnercenter.berkeley.edu/fair-tax-credit>

1.5 years, and a quarter (25%) had waiting lists of at least three years. Some of the largest PHAs had waiting lists of at least seven years.

Given the program's effectiveness, we recommend that Congress significantly expand housing vouchers provide families in need with housing choice.

While housing vouchers offer families the prospect of moving to areas of opportunity, barriers to mobility prevent many from doing so. Many private-sector landlords refuse to accept housing vouchers—whether because of the administrative costs, because vouchers do not cover the full cost of rent in high-cost areas, or outright discrimination. There are a number of steps that can be taken to address these issues, including consolidating public housing authorities' administration of vouchers within a housing market, directing HUD to adopt small area fair market rents (SAFMRs) with strong tenant protections, barring source-of-income discrimination, and funding mobility counseling pilot programs, among others.

4. Public Housing

Public housing is home to more than 1.1 million households and plays a critical role in providing safe, decent housing to families with the greatest needs. The preservation of this important community asset must be a part of any strategy to end housing poverty.

More than half (52%) of all households living in public housing are headed by a disabled and/or elderly resident, and nearly half (41%) have at least one child residing in the home. Nearly three quarters (72%) of households are considered very low or extremely low income, making less than 50% of the area median income, and the average annual tenant income is about \$13,400.

Despite its critical role, public housing capital repairs have been chronically underfunded. Today, public housing faces approximately \$45 billion in unmet capital backlog needs. As a result, HUD is unable to make the repairs needed to preserve its public housing stock and has lost 10,000 to 15,000 public housing apartments each year to obsolescence or decay.

Research shows that the vast majority of the more than 2 million people who live in public housing are satisfied with their homes, even though they rightfully push for solutions to maintenance and management issues. In fact, far more people are trying to get into public housing than leave it. In NLIHC's *Housing Spotlight: The Long Wait for a Home*, we found that public housing waiting lists had an average wait time of 9 months. Twenty-five percent of them had a wait time of at least 1.5 years.

The federal government has already invested significant resources to develop, maintain, and operate public housing. Communities will lose an important asset—and the federal government will lose all of this investment—if Congress continues to underfund public housing. We urge Congress to make a significant investment—through an infrastructure package or otherwise—in rehabilitating and preserving public housing throughout the country.

IV. Alternative Approaches

President Trump's tax reform proposal would indirectly impact the MID. By doubling the standard deduction, fewer households would claim the MID and instead would take the increased standard deduction. This could provide many low and moderate income households a greater, much-needed tax break.

However, without additional reforms, Mr. Trump's proposal would amplify the MID's regressive effect; only the wealthiest Americans would benefit. NLIHC agrees with the Wall Street Journal Editorial Board that if Congress doubles the standard deduction, it should also embrace other reforms to make MID less regressive – like reducing the size of a mortgage eligible for the MID from \$1 million to \$500,000 - and reinvest the savings into deeply targeted affordable rental housing.

V. Conclusion

NLIHC and our members look forward to working with Congress and the Trump administration to address the lack of decent, accessible, and affordable housing, especially among families with the greatest needs, through tax reform legislation. Together, we can together help end family homelessness and housing poverty once and for all.



July 19, 2017

The Honorable Peter Roskam
Tax Policy Subcommittee of the
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

The Honorable Lloyd Doggett
Tax Policy Subcommittee of the
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman and Mr. Doggett:

Please add these comments of The National Retail Federation (NRF) to the hearing record for the Tax Policy Subcommittee July 19 hearing on how tax reform will effect individuals and families.

The current impetus for tax reform has been fueled by the fact that the U.S. corporate tax rate is the highest in the industrialized world, which is driving investment out of the United States. Reducing the corporate tax rate can help increase U.S. investment, which should lead to better jobs and higher wages for families. However, the solution to reducing the corporate tax rate should not be to shift the tax burden to individuals and families through the imposition of a consumption tax.

Our retailers predict that they would have to raise price by approximately 15% to break even under the House Blueprint for tax reform because of the border adjustment tax (BAT). An NRF analysis of the plan predicts that the plan could cost the average family of four \$1700 in the first year alone, which includes a 35 cent increase in the cost of a gallon of gas. Hardest hit would be low and middle income consumers, especially those on fixed income.

NRF believes that business tax rate reduction can be achieved with base broadening and accounting for the impact of pro-growth tax policies on revenues, so-called "dynamic scoring." Since the overall purpose of pro-growth tax reform should be to improve the standard of living of the American people, it would be counter-productive to include a consumption tax in that plan.

We appreciate the opportunity to continue to work with the Committee on pro-growth tax reform. The retail industry is a strong proponent of income tax reform. We believe that income tax reform that lowers the rates and broadens the tax base can provide economic growth for the economy as a whole and can be good for the American consumer. We understand that to achieve this type of tax reform, we must be willing to give up our "tax expenditures," and we are willing to support such legislation. However, we do not believe that a new tax system that shifts the burden of taxation to the consumer is good for our industry, which is the nation's largest employer, or good for the American consumer. We urge you to reject the border adjustment tax (BAT) and adopt an income tax reform proposal that does not shift the tax burden to consumers.

Sincerely,

David French
Senior Vice President
Government Relations

cc: Ways and Means Subcommittee on Tax Policy

NATIONAL RETAIL FEDERATION
1101 New York Avenue, NW, Suite 1200
Washington, DC 20005
www.nrf.com



1700 North Moore Street, Suite 2250, Arlington, VA 22209

Statement for the Record

U.S. House Ways and Means Subcommittee on Tax Policy
Hearing on
“How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families”
July 19, 2017

Jennifer Safavian
Executive Vice President, Government Affairs
Retail Industry Leaders Association

The Retail Industry Leaders Association (RILA) appreciates the Ways and Means Subcommittee on Tax Policy holding this hearing on “How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families.” RILA welcomes the opportunity to simultaneously express our support for comprehensive tax reform that includes reform for individuals and families while expressing our strong opposition to a proposal that would hurt individuals, families, and all consumers – the border adjustable tax.

RILA is the trade association of the world’s largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales, millions of American jobs, and more than 100,000 stores, manufacturing facilities, and distribution centers located both domestically and abroad.

More than 42 million jobs in the United States are either a retail job or a job that relies on retail. With more than \$553 billion in labor income and more than \$3.8 trillion in sales, retail is one of America’s most powerful economic engines. In fact, consumer spending represents two-thirds of U.S. gross domestic product (GDP).

RILA Supports Tax Reform for Individuals and Families

Retailers have long supported comprehensive tax reform that will benefit industry and our customers alike. In earlier recent submissions to the Ways & Means Committee, RILA called for a significant reduction in the corporate tax rate, a fresh scrutiny of all deductions and credits in the code, particularly ones that are not applicable to all taxpayers, and a rejection of the border adjustable tax included in the House Republican Tax Reform Blueprint (“Blueprint”).

Under the Blueprint, tax rates for individuals and families would be reduced, thus providing more money for Americans to spend, save, and invest. This would provide a necessary boost to the economy, which is especially critical to the retail sector which has suffered significant store closings and job losses in the first half of 2017.

Impact of the Border Adjustable Tax on American Consumers

Any benefit provided under the Blueprint to individuals in the way of income tax reductions, however, would be wiped out by the proposed border adjustable tax. The border adjustable tax, which would in effect place a new 20 percent tax on imports while completely eliminating the tax on exports, will force retailers to significantly raise prices on everyday consumer staples such as food, medicine, clothing, electronics, and home improvement items. Many personal necessities like life-saving drugs and items essential to the operation of U.S. small businesses, such as cell phones, have no domestically manufactured equivalent and will not in the foreseeable future. While margins on retail goods are already low, adding the border adjustable tax on top of the cost of those goods means that retailers have no other choice than to pass this additional tax onto American families.

A May 2017 study commissioned by RILA from Capital Economics states, “[i]t is probable that the pass through of costs for other sectors may be less than it is in the case of retailing, but, if 70 percent of the burden of this tax were to be transmitted to consumer prices, American inflation in the near term could increase by 2.1 percent versus what it would otherwise be.” The study continues: “[l]ooking at the typical expenditure of a consumer unit or household in the United States each year, a 2.1 percent increase in consumer prices is equivalent to an increase in costs to consumers of \$1,218 on average, based on extrapolated 2017 consumer expenditure levels. If pass through of costs was instead complete (100 percent), the increase would be as high as \$1,739.”

The study further notes “... the impacts on consumers will be disproportionate, with consumers buying (durable and non-durable) goods being more affected than those who spend more on services such as healthcare and housing (which, inevitably, are more domestically sourced). As noted above, given that the incidence of this tax will fall on consumer spending and goods in particular, it is likely that the impacts will be regressive in nature, with poorer consumers (proportionately) most affected.”

In addition, if the border adjustable tax were to be enacted, retailers in the aggregate would be subject to a huge tax increase under the House Republican Blueprint proposal. In some cases, effective tax rates would exceed 100 percent, resulting in companies paying more in tax than their net income. Businesses in this position would have to not only raise prices on consumers, but also would significantly cut capital expenditures and reduce their workforces. In fact, the financial viability of many retailers would be placed in jeopardy. Thus, individuals and families employed in the retail sector would suffer doubly from the border adjustable tax.

Conclusion

The border adjustable tax would disproportionately impact the retail sector because we import many products that are not able to be sourced domestically. Such a drastic new border adjustable tax would completely undermine the benefits of lower tax rates for both individuals and corporations as contemplated under the Blueprint. A border adjustable tax will lead to higher



1700 North Moore Street, Suite 2250, Arlington, VA 22209

prices for American families and put many retail jobs/businesses at risk and should be rejected by Congress.

RILA and its member companies are eager to work with Members of the Ways and Means Committee in this once in a generation effort to reform the tax code in a comprehensive manner that both enhances the well-being of individuals and families as well as promotes U.S. competitiveness.

**STATEMENT FOR THE RECORD
OF
THE CHRISTIAN SCIENCE CHURCH**

**FOR THE HOUSE COMMITTEE ON WAYS & MEANS
SUBCOMMITTEE ON TAX POLICY HEARING
ON
“HOW TAX REFORM WILL SIMPLIFY OUR BROKEN TAX
CODE AND HELP INDIVIDUALS AND FAMILIES”**

JULY 19, 2017

On behalf of the Christian Science Church (“Church”), we thank Chairman Roskam, Ranking Member Doggett, and the esteemed Members of the House Ways and Means Subcommittee on Tax Policy for holding the hearing entitled, “How Tax Reform Will Simplify Our Broken Tax Code and Help Individuals and Families” on July 19, 2017.

We also applaud the Committee for advancing H.R. 2061, the Equitable Access to Care and Health (“EACH”) Act, in the previous Congress. We deeply appreciate the Committee’s leadership on fairness in the tax code and religious freedom, as embodied in the EACH Act (now H.R. 1201). The bipartisan EACH Act would provide immediate tax relief to individuals and families of faith, including Christian Scientists, who have been unfairly subject to significant penalties under the Affordable Care Act’s (“ACA”) individual mandate. The ongoing tax burden imposed on this group of Americans — simply for adhering to their religious beliefs and practices — requires Congress’ urgent attention.

**ACA’s religious conscience exemption does not appropriately address
all Americans of faith**

Under the ACA, individuals must maintain minimum essential coverage or pay a tax penalty, unless an exemption applies. The statute includes a narrow religious exemption accessible to individuals who are members of recognized religious sects described in section 1402(g)(1) of the Internal Revenue Code or health care sharing ministries. The exemption provided in section 1402(g)(1) requires members of the religious sect to conscientiously oppose the benefits of any private or public insurance, including any benefits provided under the Social Security Act.

In its current form, the exemption applies only to the Amish and certain Mennonites. It does not cover Christian Scientists, who generally participate in Social Security and in insurance programs that cover care provided by religious nonmedical providers, such as Christian Science practitioners, Christian Science nurses, and Christian Science nursing facilities. Several existing federal, state, and private employer plans provide coverage for this care, including Medicare, TRICARE, and two FEHB plans; however, no plans offered on the Exchanges provide this type of coverage.

The unintended result of the current structure of the ACA’s religious conscience exemption is that some Americans of faith are required to purchase health insurance through the Exchanges that does not cover the care that is consistent with their religious practice and individual choice, while at the same time having to pay out of pocket for the health care they actually use. The only alternative is to pay significant annual tax penalties, effectively because of their religious beliefs. Many Christian Scientists have found themselves in this untenable position since 2014.

**Swift enactment of the EACH Act necessary
to preserve religious freedom in tax policy**

To end this burdensome infringement of religious freedoms in tax policy, we urge you and your colleagues to prioritize enactment of the EACH Act this year, whether as a standalone bill or as part of any tax-related legislation.

The EACH Act, which has received broad bipartisan, bicameral support in the 113th and 114th Congresses, would expand the ACA's religious conscience exemption to include Americans who rely "solely on a religious method of healing, and for whom the acceptance of medical health services would be inconsistent with the religious beliefs of the individual." The legislation would also make whole those individuals who have been wrongfully subject to penalties under the individual mandate since 2014.

EACH is necessary, regardless of health reform result

Despite ongoing efforts to partially address the individual mandate through ACA reform legislation, we respectfully urge the Committee to consider the EACH Act without delay, comprehensively addressing the tax implications of the individual mandate for Americans of faith, including Christian Scientists. Enacting EACH into law would ensure a clear, statutory means for exemption from the law's requirements for impacted individuals and families. It would also provide appropriate retrospective relief and set an important precedent for addressing religious conscience in health and tax law going forward.

- - - - -

We commend the House Ways and Means Committee and the House of Representatives for advancing the EACH Act during each of the past two Congresses, first passing it in March 2014. In 2015, the full Committee marked up H.R. 2061 and reported it favorably to the floor, where it was introduced by then-Committee Chairman Paul Ryan and passed under suspension of the rules by a voice vote. The Senate companion legislation, S. 352, garnered bipartisan support from 35 cosponsors. In light of ongoing efforts to reform the ACA and the tax code, the Church strongly urges lawmakers to take the long overdue step of enacting the EACH Act. Church members and their families urgently need a fair solution that ends the abridgement of religious freedoms and ensures full relief from the significant tax penalties they are being required to pay.

Thank you for the opportunity to submit this statement for the record. The Church stands ready to work with Congress and the Administration to achieve this outcome as soon as possible.

—

Comments for the Record
United States House of Representatives
Committee on Ways and Means
Subcommittee on Tax Policy
Hearing on How Tax Reform Will Simplify Our Broken Tax Code and
Help Individuals and Families
Wednesday, July 19, 2017, 2:00 PM
By Michael G. Bindner
Center for Fiscal Equity

Chairman Roskam and Ranking Member Doggett, thank you for the opportunity to submit these comments for the record to the House Ways and Means Committee Subcommittee on Tax Policy. As usual, we will preface our comments with our comprehensive four-part approach, which will provide context for our comments.

- A Value Added Tax (VAT) to fund domestic military spending and domestic discretionary spending with a rate between 10% and 13%, which makes sure very American pays something.
- Personal income surtaxes on joint and widowed filers with net annual incomes of \$100,000 and single filers earning \$50,000 per year to fund net interest payments, debt retirement and overseas and strategic military spending and other international spending, with graduated rates between 5% and 25%.
- Employee contributions to Old Age and Survivors Insurance (OASI) with a lower income cap, which allows for lower payment levels to wealthier retirees without making bend points more progressive.
- A VAT-like Net Business Receipts Tax (NBRT), which is essentially a subtraction VAT with additional tax expenditures for family support, health care and the private delivery of governmental services, to fund entitlement spending and replace income tax filing for most people (including people who file without paying), the corporate income tax, business tax filing through individual income taxes and the employer contribution to OASI, all payroll taxes for hospital

insurance, disability insurance, unemployment insurance and survivors under age 60.

Simplify our broken tax code

Probably the most broken part of our tax code is how businesses are taxed. Corporations pay separate taxes while sole proprietors and "pass throughs" pay taxes through the personal income taxes of their owners. This has some people being taxed twice, regardless of whether this is appropriate to extract taxes on higher incomes not collected through the business, while others face complexity on their personal forms, as well as a different set of rules. In 2003, President Bush and the Congress tried to fix this but could not, settling instead on a lower rate for dividends and capital gains.

The results of simply cutting rates were not pretty. CEOs and investors had an incentive to keep labor costs in check and pocket all productivity gains, which were huge through automation and outsourcing. Higher tax rates would have put a damper on such behavior. Of course, because not every rich person can be a CEO and because most companies borrowed money rather than issued stock, there were few good investments, which had beneficiaries of the 2001 and 2003 tax cuts seek more exotic vehicles, like oil futures and mortgage backed securities. This (not any action by the GSEs) led to the mortgage boom and the Great Recession (as well as provisions in the 1986 tax reform that let home owners use their houses as ATMs, a provision Trump wants to keep).

The President proposes simply lowering the tax on "pass through" income, which will increase the number of companies fronting what would have been pay to individuals for salary and rent in order to take advantage of the lower rates. This is tax DEFORM not reform. We tried such cuts in 2003 and the proposed cut will yield the same result, especially if the President succeeds in defanging Dodd-Frank through regulatory reform (again deform).

There is a better way. Value Added Taxes and Net Business Receipts Taxes (Subtraction VAT) will both simplify taxation and treat all businesses in the same way. While some special tax breaks might be preserved in the NBRT, most would not because there would be no way to justify taxing the labor or an activity and not the associated profit or taxing

research salaries one way and production wages another. All profit and wage would be taxed at the same rate, which also removes the tax bias against wage income.

The proposed Destination-Based Cash Flow Tax is a compromise between those who hate the idea of a value-added tax and those who seek a better deal for workers in trade. It is not a very good idea because it does not meet World Trade Organization standards, though a VAT would. It would be simpler to adopt a VAT on the international level and it would allow an expansion of family support through an expanded child tax credit. Many in the majority party oppose a VAT for just that reason, yet call themselves pro-life, which is true hypocrisy. Indeed, a VAT with enhanced family support is the best solution anyone has found to grow the economy and increase jobs.

Some oppose VATs because they see it as a money machine, however this depends on whether they are visible or not. A receipt visible VAT is as susceptible to public pressure to reduce spending as the FairTax is designed to be, however unlike the FairTax, it is harder to game. Avoiding lawful taxes by gaming the system should not be considered a conservative principle, unless conservatism is in defense of entrenched corporate interests who have the money to game the tax code.

Our VAT rate estimates are designed to fully fund non-entitlement domestic spending not otherwise offset with dedicated revenues. This makes the burden of funding government very explicit to all taxpayers. Nothing else will reduce the demand for such spending, save perceived demands from bondholders to do so – a demand that does not seem evident given their continued purchase of U.S. Treasury Notes.

Value Added Taxes can be seen as regressive because wealthier people consume less, however when used in concert with a high-income personal income tax and with some form of tax benefit to families, as we suggest as part of the NBRT, this is not the case.

This is not to say that there will be no deductions. The NBRT will be the vehicle for social spending through the tax code.

The NBRT base is similar to a Value Added Tax (VAT), but not identical. Unlike a VAT, an NBRT would not be visible on receipts and should not be zero rated at the border – nor should it be applied to imports. While both collect from consumers, the unit of analysis for the NBRT should be the business rather than the transaction. As such, its

application should be universal – covering both public companies who currently file business income taxes and private companies who currently file their business expenses on individual returns.

In the long term, the explosion of the debt comes from the aging of society and the funding of their health care costs. Some thought should be given to ways to reverse a demographic imbalance that produces too few children while life expectancy of the elderly increases.

Unassisted labor markets work against population growth. Given a choice between hiring parents with children and recent college graduates, the smart decision will always be to hire the new graduates, as they will demand less money – especially in the technology area where recent training is often valued over experience.

Separating out pay for families allows society to reverse that trend, with a significant driver to that separation being a more generous tax credit for children. Such a credit could be “paid for” by ending the Mortgage Interest Deduction (MID) without hurting the housing sector, as housing is the biggest area of cost growth when children are added. While lobbyists for lenders and realtors would prefer gridlock on reducing the MID, if forced to choose between transferring this deduction to families and using it for deficit reduction (as both Bowles-Simpson and Rivlin-Domenici suggest), we suspect that they would choose the former over the latter if forced to make a choice. The religious community could also see such a development as a “pro-life” vote, especially among religious liberals.

Enactment of such a credit meets both our nation’s short term needs for consumer liquidity and our long term need for population growth. Adding this issue to the pro-life agenda, at least in some quarters, makes this proposal a win for everyone.

The NBRT should fund services to families, including education at all levels, mental health care, disability benefits, Temporary Aid to Needy Families, Supplemental Nutrition Assistance, Medicare and Medicaid. If society acts compassionately to prisoners and shifts from punishment to treatment for mentally ill and addicted offenders, funding for these services would be from the NBRT rather than the VAT.

The NBRT could also be used to shift governmental spending from public agencies to private providers without any involvement by the government – especially if the several states adopted an identical tax structure. Either employers as donors or workers as recipients could designate that revenues that would otherwise be collected for public schools would instead fund the public or private school of their choice. Private mental health providers could be preferred on the same basis over public mental health institutions. This is a feature that is impossible with the FairTax or a VAT alone.

To extract cost savings under the NBRT, allow companies to offer services privately to both employees and retirees in exchange for a substantial tax benefit, provided that services are at least as generous as the current programs. Employers who fund catastrophic care would get an even higher benefit, with the proviso that any care so provided be superior to the care available through Medicaid. Making employers responsible for most costs and for all cost savings allows them to use some market power to get lower rates, but not so much that the free market is destroyed. Increasing Part B and Part D premiums also makes it more likely that an employer-based system will be supported by retirees.

Conceivably, NBRT offsets could exceed revenue. In this case, employers would receive a VAT credit.

The income surtax is earmarked for overseas military, naval sea and international spending because this spending is most often deficit financed in times of war. Earmarking repayment of trust funds for Social Security and Medicare, acknowledges the fact that the buildup of these trust funds was accomplished in order to fund the spending boom of the 1980s without reversing the tax cuts which largely benefited high income households.

Reduce the burdens on American families and individuals

The shift from an income tax based system to a primarily consumption based system will dramatically decrease participation in the personal income tax system to only the top 20% of households in terms of income. Currently, only roughly half of households pay income taxes, which is by design, as the decision has been made to favor tax policy to redistribute income over the use of direct subsidies, which have the stink of welfare.

This is entirely appropriate as a way to make work pay for families, as living wage requirements without such a tax subsidy could not be sustained by small employers.

Simplicity and burden reduction are very well served by switching from personal income taxation of the middle class to taxation through a value added tax. For these people, April 15th simply be the day next to Emancipation Day for the District. The child tax credit will be delivered with wages as an offset to the Net Business Receipts tax without families having to file anything, although they will receive two statements comparing the amount of credits paid to make sure there are no underpayments by employers or overpayments to families who received the full credit from two employers.

Small business owners will get the same benefits as corporations by the replacement of both pass through taxation on income taxes and the corporate income tax with the net business receipts tax. As a result, individual income tax filing will be much simpler, with only three deductions: sale of stock to a qualified ESOP, charitable contributions and municipal bonds – although each will result in higher rates than a clean tax bill.

The expansion of the Child Tax Credit in the NBRT is what makes tax reform worthwhile. Adding it to the employer levy rather than retaining it under personal income taxes saves families the cost of going to a tax preparer to fully take advantage of the credit and allows the credit to be distributed throughout the year with payroll. The only tax reconciliation required would be for the employer to send each beneficiary a statement of how much tax was paid, which would be shared with the government. The government would then transmit this information to each recipient family with the instruction to notify the IRS if their employer short-changes them. This also helps prevent payments to non-existent payees.

Assistance at this level, especially if matched by state governments may very well trigger another baby boom, especially since adding children will add the additional income now added by buying a bigger house. Such a baby boom is the only real long term solution to the demographic problems facing Social Security, Medicare and Medicaid, which are more demographic than fiscal. Fixing that problem in the right way definitely adds value to tax reform.

A Value Added Tax gives everyone the privilege and responsibility to fund discretionary government services delivered in the United States. Everyone pays a proportional share of their consumption. If taxes really are too high, we will know where to cut. The NBRT will fund social services thorough employers. It allows people who need more to get more, even if in an unregulated economy they could not afford it. Starvation is not liberty, especially for children. The high income and inheritance surtax undoes the redistribution up by shifting payment for net interest and debt reduction to those who benefited the most from out of control tax cuts under Reagan and Bush. Those debts are not universal, they adhere to future taxpayers who with the income to pay higher rates, the children of the wealthy.

Deliver economic growth that creates jobs and improves the quality of life of all Americans

The tax reforms detailed here will make the nation truly competitive internationally while creating economic growth domestically, not by making job creators richer but families better off. The Center's reform plan will give you job creation. The current blueprint and the President's proposed tax cuts for the wealthy will not.

In September 2011, the Center submitted comments on Economic Models Available to the Joint Committee on Taxation for Analyzing Tax Reform Proposals. Our findings, which were presented to the JCT and the Congressional Budget Office (as well as the Wharton School and the Tax Policy Center), showed that when taxes are cut, especially on the wealthy, only deficit spending will lead to economic growth as we borrow the money we should have taxed. When taxes on the wealthy are increased, spending is also usually cut and growth still results. The study is available at

<http://fiscalequity.blogspot.com/2011/09/economic-models-available-to-joint.html>

and it is likely in use by the CBO and JTC in scoring tax and budget proposals. We know this because their forecasts and ours on the last Obama budget matched. Advocates for dynamic scoring should be careful what they wish for.

Value added taxes act as instant economic growth, as they are spur to domestic industry and its workers, who will have more money to spend. The Net Business Receipts Tax as we propose it includes a child tax credit to be paid with income of between \$500 and

\$1000 per month. Such money will undoubtedly be spent by the families who receive it on everything from food to housing to consumer electronics.

The high income and inheritance surtax will take money out of the savings sector and put it into government spending, which eventually works down to the household level. Growth comes when people have money and spend it, which causes business to invest. Any corporate investment manager will tell you that he would be fired if he proposed an expansion or investment without customers willing and able to pay. Tax rates are an afterthought.

Our current expansion and the expansion under the Clinton Administration show that higher tax rates always spur growth, while tax cuts on capital gains lead to toxic investments – almost always in housing. Business expansion and job creation will occur with economic growth, not because of investment from the outside but from the recycling of profits and debt driven by customers rather than the price of funds. We won't be fooled again by the saccharin song of the supply siders, whose tax cuts have led to debt and economic growth more attributable to the theories of Keynes than Stockman.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Contact Sheet

Michael Bindner
Center for Fiscal Equity
237 Hannes Street
Silver Spring, MD 20901
240-641-4617
fiscalequitycenter@yahoo.com

**Committee on Ways and Means
Subcommittee on Tax Policy
Hearing on How Tax Reform Will Simplify Our Broken Tax Code and
Help Individuals and Families
Wednesday, July 19, 2017, 2:00 PM**

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.



**Written Testimony of
Scott Smith
President
Precious Metals Association of North America**

Before the

**House Committee on Ways and Means
Subcommittee on Tax Policy**

**Hearing on “How Tax Reform Will Simplify our Broken Tax Code and Help Individuals
and Families”**

Wednesday, July 19, 2017

Chairman Roskam and Members of the Subcommittee,

My name is Scott Smith and I am the CEO of Pyromet, which is a privately owned precious metals manufacturer and refiner of silver, gold, and platinum group metals. Since 1969, Pyromet is a reputable name in precious metals and precious metals management. I also serve as President of the of the Precious Metals Association of North America (PMAA) and am submitting this written testimony on behalf of our members. Our association’s members are made up of refiners, manufacturers, traders, and distributors of products that are essentially comprised of precious metals such as gold, silver, platinum, and palladium. All of our members have a vested interest in tax reform – in particular, changes to the capital gains rate for investments in precious metal coins and bars.

Background

Right now, it is impossible to turn on the television without seeing an advertisement for investing in precious metals bullion coins and bars. These are great opportunities for people to include tangible assets into their portfolios. Since 1982, gains made on precious metals bullion have been taxed at the ordinary income rate due to language defining such bullion as a collectible. Congress has made numerous attempts to mitigate the effects of this capital gains treatment on precious metals. The Tax Reform Act of 1986 granted the American Eagle family of coins an exemption from the ‘collectible’ definition and allowed them to be included as equity investments in Individual Retirement Accounts. Over a decade later, the Taxpayer Relief Act of 1997 created purity and custody standards that, if met, would exempt bullion coins and bars from the definition while also allowing them in IRAs. Furthermore, precious metals investment grade bullion products are purposely designed and produced in a way that excludes any assumption

that they are rare or unique collectibles. Instead, investment grade bullion products are mass produced to be offered as investments strictly for their precious metal content.

Regulatory Inconsistencies

Since 1986, Congress and the U.S. Treasury have recognized the value of investing in precious metal bullion, thus making some exemptions from the 'collectible' definition. However, the 'collectible' definition remains for non-IRA investments in precious metals, and these investments are taxed at the ordinary income rate for collectibles with a maximum rate of 28% - a rate 40% greater than the capital gains rate for equity investments. To better understand this inconsistency, I want to briefly explain the different types of coins and the distinctions between them.

Coins – Function vs Form

Coins belong to one of three basic categories that consider the coin's function and form. All coins are round in form. However, there is a critical difference in the concept of *form* and that of *function*. For example, while all airplanes have wings and tails and are designed to fly, different types of airplanes fulfill different functions. One wouldn't employ a Boeing 747 airliner to perform a fighter mission. Similarly, there are different categories of coins that have different roles, and each type is distinguished from the others by its *function* or purpose.

There are three basic categories of coins in the world today; each one serves a specific role:

1. Monetary Coins – These coins are part of a country's circulating currency that its citizens routinely use as money. Coins in circulation today contain no precious metal. The value of these coins (commonly referred to as their "legal tender" or "face" value) is set in law by government decree. In the United States, of course, these would include pennies, nickels, dimes, quarters, half-dollars, and now, the new "Sacagawea" dollar coin. They are used as a medium of exchange by which the general public effects everyday transactions, such as when they pay for candy bars, newspapers, parking meters, bridge tolls, etc. The purpose of these coins is to circulate in the general economy. They are not hoarded for their uniqueness or rarity, or because they have any premium value over their legal tender amount.

2. Rare Coins – These coins are commonly referred to as "numismatic" coins, that is, they are held by, valued and traded among hobbyists and coin collectors on the basis of their rarity and the quality of their physical condition. Typically, numismatic coins are old (sometimes ancient), and they may, or may not contain a precious metal. The market value of numismatic coins usually far exceeds either their face value or their precious metal content (if any). Their market values are determined by supply and demand factors that exist in the rare coin market for particular coins based largely on subjective judgments made about their scarcity and condition. Such coins may be held for enjoyment (e.g., as in a hobby), or for investment purposes, or both, just as an antique rug or a rare painting may be purchased simply for the enjoyment of its owner, or specifically for its price appreciation potential. Thus, profits through capital gains may be realized when rare coins are sold, but because they are unique, their value determinations can vary and can be quite subjective.

3. Bullion Coins – Bullion coins are fungible, highly refined precious metals products, round in shape, and produced to exacting specifications in large numbers by numerous countries throughout the world specifically as precious metal investment vehicles. They are widely traded, highly liquid and their market values are globally publicized. Although they typically are ascribed legal tender status by the governments that mint them, bullion coins trade in the marketplace at or near the market price of the commodity they contain, which typically has no relationship whatsoever to the coin's legal tender, or "face" value. For example, earlier this year, a one-ounce American Eagle gold bullion coin having a U. S. *legal tender value* of \$50, traded in the market place at \$1,277.35, while gold itself was trading at a "spot price" of \$1,239.85 per ounce. Thus, the price of the gold Eagle was at a \$37.50 premium (3%) to the prevailing gold bullion price.

It is important to note that the premium charged for a bullion coin over and above the current "spot price" of the corresponding commodity it contains merely reflects the cost of insurance, transportation, handling, and storage, as well as the manufacturer's and dealer's profit, associated with the processing and sale of the coin. This premium is not a value ascribed to the coin as the result of any rarity or uniqueness considerations. In fact, bullion coins are purposely manufactured in sufficient quantities by their governments to ensure they are not "rare" or "scarce," but are as common as the many types of bullion bars available also produced by commercial refiners specifically for investment purposes. Therefore, bullion coins should be recognized and treated in the tax code as any other investment.

Recognizing precious metals coins and bars as investment products, the Wall Street Journal publishes each business day in its investment section, the market prices of gold, silver, platinum and palladium bullion as well as the prices the most widely traded bullion coins. Additional substantiation of the investment status of bullion coins and bars is evident in the fact that twenty-one states have removed their sales tax on bullion coins and bars.

Policy Proposal

Unlike rare coins – which include those most pursued by hobbyists and collectors – bullion coins are precious metal investment vehicles that are traded at the value of the commodity they contain. Since they are not rare, but rather mass produced specifically for investing, their status as a 'collectible' for non-IRA investments is misaligned with their function and form. That is why I am requesting on behalf of the PMANA that Congress amend the Internal Revenue Code to treat gold, silver, platinum, and palladium in either bullion or coin form, in the same manner as stocks, bonds, and mutual funds for purposes of the capital gains rate for individuals.

Thank you and I look forward to working with the Subcommittee to ensure a reformed tax code that is fair to investors and promotes more investments in precious metal bullion coins and bars. If you have any questions, I am happy to meet with you and/or your staff to discuss this issue in greater detail. Thank you for the time and I hope the Committee will look closely at this issue and the impacts it has on American investors.